audit report

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TO: Rodger J. Boyd, Deputy Assistant Secretary, Office of Native American Programs, PN

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region X, 0AGA

SUBJECT: NAHASDA Program Income from 1937 Act Properties

HIGHLIGHTS

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development (HUD) Office of Native American Program's (ONAP) rules regarding calculation of program income under the Native American Housing and Self-Determination Act of 1996 (NAHASDA). The scope was limited to NAHASDA-assisted housing which originated from the former Housing Act of 1937 (1937 Act). We selected this subject for review based on ONAP's agreement to use rent collected from low-income tenants of HUD-subsidized tribal housing to repay $246,600 in unallowable and undocumented expenses charged to the Tulalip Housing Authority's NAHASDA grants.

Our objectives were to determine whether ONAP's guidance on calculating program income for the NAHASDA-assisted 1937 Act housing projects was consistent with generally accepted accounting principles. We also wanted to determine whether the effects of implementing this guidance were consistent with the purpose and goals of NAHASDA. The audit steps were designed to provide an understanding of the accounting for program income from 1937 Act-assisted properties and the requirements affecting development of policy and guidance.

What We Found

Policies established by ONAP allowed tribal housing authorities to redirect and abuse rent revenue from NAHASDA-assisted Low Rent program units developed under the

1937 Act. This condition occurred because HUD's program income regulations are ambiguous and ONAP's corresponding program income guidance is not consistent with generally accepted accounting principles. Further, ONAP allowed tribal authorities to claim these funds as unrestricted income retroactively to 1998 and use the funds to cover expenditures that are not permitted under NAHASDA.

As a result, tribal housing authorities redirected and abused millions of dollars in rent collected from low-income Native Americans living in NAHASDA-assisted units. While the total amount of redirected revenue is not known, we observed over $12.6 million redirected from 1937 Act properties. Nationwide, ONAP's program income guidance provided tribes the opportunity to redirect up to $40 million per year in rent revenue from NAHASDA-assisted 1937 Act properties. This amount totals about $400 million in NAHASDA-assisted rental revenue that is currently unrestricted or available to be retroactively reclassified as unrestricted by restating accounting records back to 1998. HUD lacks assurance that all of these funds have been used to maintain existing rental properties or to assist other families in obtaining affordable housing in conformance with the purpose and goals of NAHASDA.

What We Recommend

We recommend that HUD's Deputy Assistant Secretary, Office of Native American Programs, (1) take immediate action to suspend the redirecting of revenue from NAHASDA-assisted 1937 Act units unless all costs for operation, maintenance, rehabilitation, and capital improvement have been reimbursed by offsetting expenses against revenue of those units in a method consistent with self-sufficiency and (2) rescind Public and Indian Housing Notice 2000-18 and associated guidance, such as Program Guidance Memorandums 2001-3T and 2002-12, until appropriate guidance can be designed that supports the purpose and goals of NAHASDA.

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 a discussion draft to ONAP on November 21, 2008, and held an exit conference on December 4, 2008. ONAP disagreed with our report findings. ONAP believes the tribal ownership of income from 1937 Act properties was a policy determined in negotiated rulemaking and is a matter of self-determination.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix A of this report.

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BACKGROUND AND OBJECTIVES

Previous Assistance under the 1937 Act

The Housing Act of 1937 (1937 Act), as amended, included grants to Indian housing authorities for the development, modernization, and operation of several low-income housing programs including the Low Rent and Mutual Help homeownership programs. Operation of the Low Rent program was provided by a subsidy program in which funding was provided to meet the operating needs that could not be met by existing rental revenue. Therefore, the 1937 Act regulations and annual contributions contracts for the Low Rent program did not use program income terminology. The Mutual Help program allowed Indian housing authorities to help low-income Indian families purchase a home. A family made monthly payments based on 15 to 30 percent of its adjusted income. Payments credited to an equity account were used to purchase the home.

The operating subsidies were provided to each Indian housing authority (authority) to offset, in part, the cost of operating its dwelling units in accordance with Section 9(a) of the 1937 Act as amended. Operating subsidies were considered grant funds. The performance funding system was the formula used to calculate the amount of operating subsidy for each authority.

The operating subsidy was equal to the allowable expense level plus the allowable utilities expense level plus other costs less the estimated operating income of the project. Essentially, the allowable expense level was based on what it would cost a well-managed authority of comparable location and characteristics to operate based on such variables as local government wage rate index, number of bedrooms per high rise family project, and number of bedrooms per unit. The resulting allowable expense levels were arrived at by application of the formula using these variables.

Assistance under NAHASDA

The Native American Housing and Self-Determination Act of 1996 (NAHASDA) reorganized the U.S. Department of Housing and Urban Development's (HUD) system of housing assistance to Native Americans, eliminating several assistance programs and replacing them with a block grant program. The purpose and goals of NAHASDA and implementing regulations are attached to this report in appendix D.

The primary objectives of NAHASDA are

(1) To assist and promote affordable housing activities to develop, maintain, and operate affordable housing in safe and healthy environments on Indian reservations and in other Indian areas for occupancy by low-income Indian families;

(2) To ensure better access to private mortgage markets for Indian tribes and their members and to promote self-sufficiency of Indian tribes and their members;

(3) To coordinate activities to provide housing for Indian tribes and their members with federal, state, and local activities to further economic and community development for Indian tribes and their members;

(4) To plan for and integrate infrastructure resources for Indian tribes with housing development for tribes; and

(5) To promote the development of private capital markets in Indian country and to allow such markets to operate and grow, thereby benefiting Indian communities.

The two programs authorized for Indian tribes under NAHASDA are the Indian Housing Block Grant, a formula-based grant program, and Title VI Loan Guarantee, which provides financing guarantees to Indian tribes for private market loans to develop affordable housing. The Indian Housing Block Grant formula currently uses the fiscal year 1996 national average operating subsidy, adjusted for inflation and local area costs, as the basis for per unit funding to an Indian tribe to operate 1937 Act housing.

NAHASDA's Negotiated Rulemaking

Section 106 of NAHASDA requires HUD to "establish any requirements necessary to provide for the transition" from assistance under the 1937 Act to assistance under NAHASDA. Section 106(b)(2)(A) provides that all regulations be created through the negotiated rulemaking process under subchapter III of chapter 5 of title 5, *United States Code*. Accordingly, the Secretary of HUD established the Native American Housing Assistance and Self-Determination Negotiated Rulemaking Committee to negotiate and develop a proposed rule implementing NAHASDA.

The committee consisted of 58 members. Forty-eight of these members represented geographically diverse small, medium, and large Indian tribes. There were 10 HUD representatives on the committee. A number of HUD officials, committee members, and guests commented on the scrutiny placed upon Indian housing as a result of a Seattle Times report on the mismanagement of Indian housing funds and the resulting media attention and congressional hearings. The Assistant Secretary for Public and Indian Housing stated that the stories highlighted the issues in Native American housing and that HUD needed to address the issues. He made it clear that the committee existed, in part, to respond to the troubles with past programs. On March 12, 1998, HUD published the final rule implementing the NAHASDA regulations at 24 CFR [*Code of Federal Regulations*] 1000.

Our Objective

Our objective was to determine whether HUD's Office of Native American Programs' (ONAP) guidance on calculating program income for the NAHASDA-assisted 1937 Act housing projects was consistent with generally accepted accounting principles. We also wanted to determine whether the effects of implementing this guidance were consistent with the purpose and goals of NAHASDA.

RESULTS OF AUDIT

Finding 1: HUD's Guidance Allowed Tribes to Redirect and Abuse Rent Revenue from Low-Income Housing

Policies established by ONAP allowed tribal housing authorities to redirect and abuse rent revenue from NAHASDA-assisted Low Rent program units developed under the 1937 Act. This condition occurred because HUD's program income regulations are ambiguous and ONAP's corresponding guidance documents were not consistent with generally accepted accounting principles. As a result, tribal housing authorities redirected and abused millions of dollars in rent collected from Native Americans living in NAHASDA-assisted units. While the total amount of redirected revenue is not known, we observed over $12.6 million redirected from 1937 Act properties. Nationwide, ONAP's program income guidance provided tribes the opportunity to redirect up to $40 million per year in rent revenue from NAHASDA-assisted 1937 Act Low Rent program properties. This amount totals about $400 million in NAHASDA-assisted rental revenue that is currently unrestricted or available to be retroactively reclassified by the tribes as unrestricted by restating the accounting records back to 1998. HUD lacks assurance that all of these funds have been used to maintain existing rental properties or to assist other families in obtaining affordable housing in accordance with the purposes and goals of NAHASDA.

HUD's Implementation of NAHASDA

The 1937 Act grants were cancelled by NAHASDA, Section 502. Section 502 provides that 1937 Act assets "shall be considered and maintained as affordable housing for purposes of this Act." Section 203(b) states that tribes "shall, using amounts of any grants received under [NAHASDA], reserve and use for operating assistance under section 202(1) such amounts as may be necessary to provide for the continued maintenance and efficient operation of [1937 Act] housing." In addition, NAHASDA Section 210 specified that 1937 Act unobligated reserves and cash accounts were to transition into the new program.

Accordingly, tribes can operate 1937 Act assets without assistance or can apply for assistance under NAHASDA. To determine what restrictions are placed on revenue received from occupants of any NAHASDA-assisted 1937 Act units, tribal housing authorities must comply with 24 CFR 1000.62 and were instructed to follow the guidance of Public and Indian Housing (PIH) Notice 2000-18, section 3.4, both found in appendix E of this report.

The regulations at 24 CFR 1000.62(a) state, "Program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance." If grant funds are not used to assist a 1937 Act unit, any revenues would not be program income. However, if

grant funds are used, the asset generates program income when that income is "attributed" to the assistance. There is no definition of the word "attribute" in the regulation. Section 1000.62(d) continues, "Costs incident to the generation of program income shall be deducted from gross income to determine program income."

These rules on program income apply to all NAHASDA-assisted 1937 Act units, both rental and homeownership units. However, homeownership units do not typically create program income until the end of the homeownership agreement. Also, those revenues are not easily estimated and are less restricted than other NAHASDA program income.[1] Therefore, this report's discussion focuses on the immediate impact of unrestricted funds produced by 1937 Act Low Rent program units.

Development of Program Income Rules and Guidance

During the development of negotiated rules, a committee, consisting of tribal representatives and officials from ONAP, discussed the rules relating to the calculation of program income for NAHASDA-assisted 1937 Act units. According to the committee meeting notes, "The committee discussed how the problem of separating program income from other income for accounting purposes would be addressed. One acceptable solution of these accounting questions would be as follows:

- Step 1. Determine the recipient's net income. (Total accrued income less total accrued expenses equal total net income.)
- Step 2. Determine the funding source of the recipient's assets…"

The notes show an objection by an Office of General Counsel staff attorney, who stated that the language was not consistent with the regulations. She stated that the regulations did not permit subtracting total expenses from total assets to find net income.

After some additional discussion, the Deputy Assistant Secretary for ONAP stated that one reason the committee had experienced difficulty in developing the language was because there were not enough technical experts present to ensure the members of the validity of their work. She stated that she wanted to make sure that such technical experts would be present during the joint development of guidance, later issued in PIH Notice 2000-18.

Despite the concern for technical accuracy, ONAP did not nominate any of its own accounting professionals to the committee developing program income accounting guidance.

[1]Mutual Help program homeownership proceeds of sale are restricted to any housing activity, community facility, or economic development activity, as published on page 15779 of the *Federal Register*/Vol. 64, No. 62/Thursday, April 1, 1999/Notices.

Tribes Allowed to Redirect Rent Revenue from Assisted Units

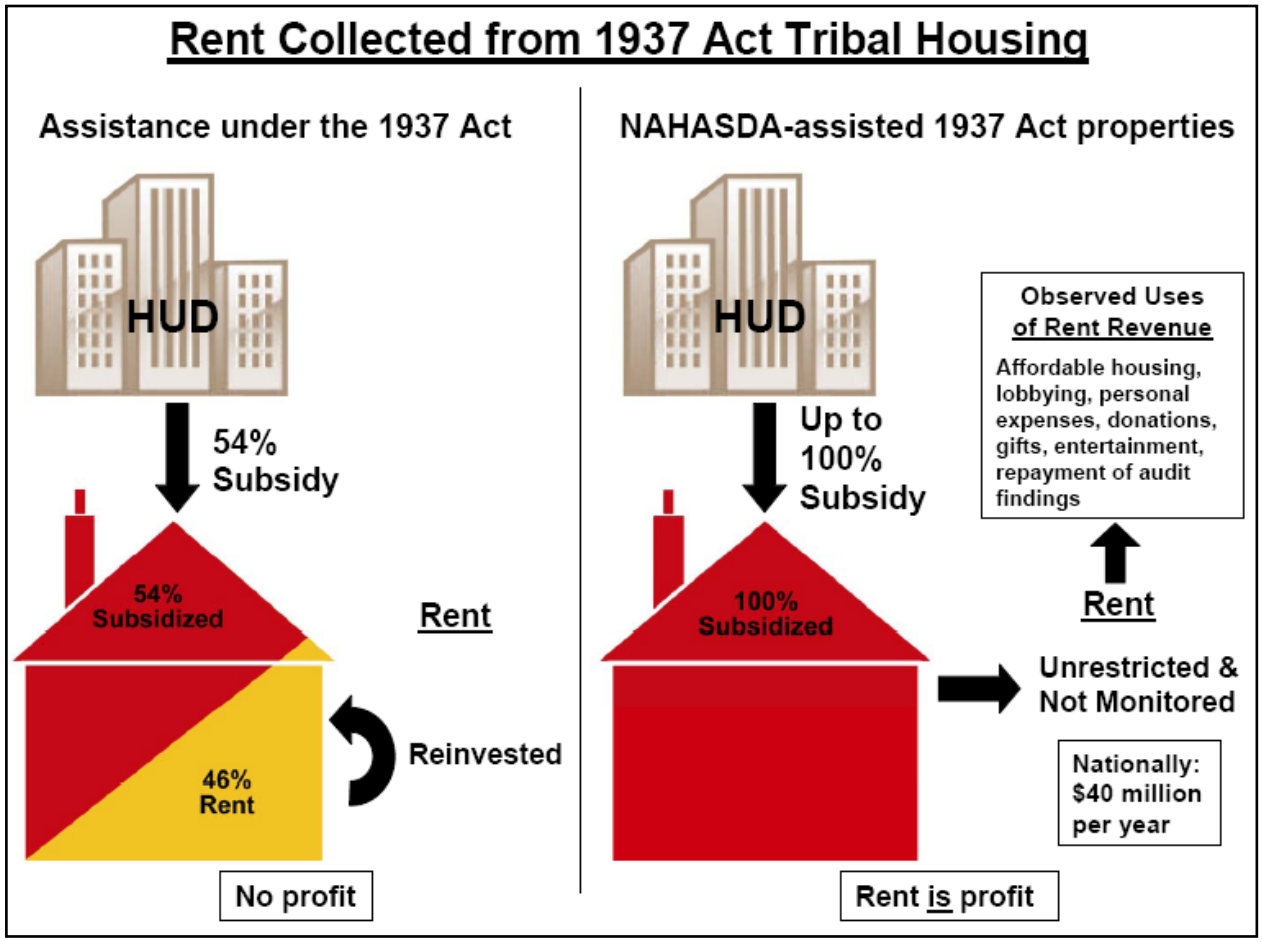
A seven-member workgroup consisting of four tribal/tribally designated housing entities and three HUD representatives was appointed by the co-chairs of the NAHASDA Negotiated Rulemaking Committee to develop guidance for calculating program income for the NAHASDA-assisted 1937 Act units. PIH Notice 2000-18, issued on April 20, 2000, was the product of that workgroup. According to section 3.4 of the notice, "When 1937 Housing Act units are assisted with IHBG [Indian Housing Block Grant] funds, the income from the units is program income if it is attributable to the IHBG assistance." It continues, "Program income is the amount of total income for a project identified as Formula Current Assisted Stock (FCAS) on the tribe's Formula Response Form that exceeds [estimated 1996 rent revenues][2] times the number of units in the project."

Based upon the guidance provided by the notice, ONAP officials instructed tribes to deduct expenses of generating income to determine program income only if they were using the income to pay these costs. This guidance allowed tribes to declare that the rents collected for their 1937 Act units were not being used for the operation and maintenance of these units.

ONAP further instructed that for the 1937 Act units, the tribes could then deduct and redirect the estimated 1996 rent revenue amount from the total rent revenue collected to determine the final program income amount. In practice, most or all of the rental income could be redirected before applying the expenses related to the operation of the rental units since the rental income usually did not exceed the estimated 1996 revenue amounts. Expenses that would have otherwise been covered by rent revenue were paid with NAHASDA grant funds.

The following chart compares the use of HUD assistance and related rental revenues from 1937 Act Low Rent program housing units before and after the implementation of the NAHASDA program income accounting guidance found in PIH Notice 2000-18.

[2] Section 3.4 of the notice defines 46 percent of the allowable expense level for the recipient as the surrogate for the national average rents received for 1937 Act units in the last year of the 1937 Act programs for Indians. The allowable expense level and 46 percent of the allowable expense level for each Indian tribe with 1937 Act units are set forth in the appendix to PIH Notice 2000-18, and the levels are defined in 24 CFR 1000.302.



Program Income Guidance Was in Conflict with NAHASDA Goals and Generally Accepted Accounting Principles

The redirected rent revenues were not considered program income by ONAP, and tribes were permitted to use these funds for any purpose, including purposes unrelated to affordable housing, without restrictions. Consequently, ONAP guidance created an unnecessary obligation for the government to pay for the operations and maintenance of units with NAHASDA grant funds when rent revenues were already available to cover these expenses.

Using NAHASDA funds instead of rent revenue to cover expenses results in less NAHASDA funds being available for affordable housing activities, counter to the goals established by Congress for both NAHASDA and the 1937 Act. Those goals are to provide funding to assist and promote affordable housing activities for Indian tribes as well as NAHASDA's goal of promoting the self-sufficiency of Indian tribes and their

members. Further, the calculation of program income allowed under the notice was inconsistent with the fundamentals of accounting, since it did not provide for the matching of rental unit operating expenses against the rental income generated by these units.

The notice's guidance for the calculation of program income deviated from the regulation at 24 CFR 1000.62(d), which states, "Costs incident to the generation of program income shall be deducted from gross income to determine program income." Instead, the guidance invented a method of fund-based accounting, which split the accounting for operational expenses from revenue collections based on a perception of unrestricted ownership of those revenues by the tribes. This separation resulted in an unrestricted revenue stream for the tribe that was unrelated to operations.

This new unrestricted revenue stream was roughly equivalent to former rent collections under the 1937 Act, which were restricted to supporting low-income housing. NAHASDA program income guidance stated that the income that was received from the 1937 Act units before the enactment of NAHASDA must be considered when calculating program income. ONAP officials determined that historical 1937 Act rent revenues were allowed to be redirected from the program as unrestricted revenue since the previous grants were canceled.

To meet the requirements of 24 CFR 1000.62(d) and conform with generally accepted accounting principles, tribes should have been instructed to deduct the operating expenses of the unit from the rents collected (gross income) before determining that program or unrestricted income existed. Following this principle and the regulation would prevent having to use NAHASDA funds to make up for the redirecting of rent revenues needed for the operation of these units, freeing up NAHASDA funds to provide additional housing assistance to low-income individuals.

The amount allowed to be redirected is a mathematical formula based on figures in the appendixes to PIH Notice 2000-18. The calculation equals the number of 1937 Act current assisted stock rental units claimed by tribes for 2008 funding, times 46 percent of the monthly allowable expense level figure for each tribe as published in PIH Notice 2000-18, times 12 months. The following examples demonstrate the calculation for four tribal housing authorities.

Tribe	Low-rent units	Allowable expense level	Times 12 months	Times 46 percent	Annual maximum unrestricted income
Oneida Tribe	194	184	12	46%	$ 197,042
Salish and Kootenai Tribes	414	211	12	46%	482,194
Navajo Nation	3,528	293	12	46%	5,706,046
Warm Springs Tribes	100	220	12	46%	121,440
Total	4,236				$ 6,506,722

Total rent revenue was reduced by this annual maximum before tribes matched the remaining revenue and expenses from operations to compute remaining income, which was attributed to NAHASDA assistance. In those instances in which tribes collected less rent from these units than the maximum unrestricted income, unrestricted income was limited to actual rent revenue.

However, this method fails to match the "costs incident to the generation of program income" with "gross income to determine program income" as required by 24 CFR 1000.62(d) and generally accepted accounting principles.[3] Instead of using gross income (revenue), the guidance matched costs with a reduced income figure after redirecting rent revenue as unrestricted income.

1937 Act Unit Rent Revenue Was Used for Wasteful or Abusive Expenditures

When rental income from NAHASDA-assisted 1937 Act rental units was treated by the tribes as unrestricted funds in accordance with the notice, the use of that income was not monitored by ONAP. In the examples of NAHASDA-assisted 1937 Act housing observed during our external audit work, most tribal authorities left no significant rent revenue to pay expenses after redirecting the estimated 1996 rent revenue amounts as unrestricted income from the rents collected. In addition, some tribal authorities used the unrestricted income for wasteful or abusive expenditures including (1) lobbying expenses; (2) misuse by housing officials for items such as excessive pay and bonuses, excessive travel reimbursements, entertainment, gifts, and personal expenses; (3) reimbursements to NAHASDA for ineligible costs; and (4) ineligible business enterprises.

After first observing this abuse at the Tulalip Housing Authority, we reviewed the use of income from NAHASDA-assisted 1937 Act properties at four more tribal housing authorities. We observed over $11 million in expenditures that would be considered abuses under NAHASDA.

Our first exposure to the issue was during the resolution of our audit report recommendations for the Tulalip Housing Authority (Audit Report Number 2005-SE-1001). ONAP agreed to allow rent collected from low-income tenants of HUD-subsidized tribal housing to repay $246,600 in unallowable and undocumented expenses. Those expenses included food, stipends, travel, entertainment, cell phone charges, and credit card reimbursements. As a result of this observation, we reviewed the use of 1937 Act unit income at four additional tribal housing authorities.

[3] To be allowable under federal awards, costs must meet general guidelines, which include generally accepted accounting principles. Those requirements are incorporated into OMB Circular A-87 (2 CFR 225, appendix A, paragraph C.1.g) and OMB Circular A-133 (subpart B, section .505.a.). These circulars are both requirements of the NAHASDA negotiated regulations.

The Warm Springs Housing Authority (Warm Springs) converted the rent revenue from its NAHASDA-assisted 1937 Act properties into unrestricted income. Although it used some of the unrestricted income funds for operation of other low-income housing, it also used those funds to pay $119,861 in unsupported compensation of housing officials and $204,456 in unsupported travel expenses questioned during a 2003 ONAP monitoring review. Later, the tribe removed the housing board and hired a new executive director. To repay these findings, the Northwest ONAP office allowed the tribe to retroactively calculate and claim the maximum unrestricted income back to 1998 although Warm Springs did not have sufficient records to attribute NAHASDA's share of that revenue.

Since then, additional uses of income generated from 1937 Act properties have included $121,390 in unallowable tenant bad debt written off primarily in the 2003 financial audit, $18,495 in other HUD-rejected expenses, and $6,964 in additional questioned travel from a Warm Springs internal audit. Warm Springs also used $11,176 for unreimbursed personal expenses of former board members and key employees on Warm Springs credit cards. These expenses included travel, entertainment, fuel, local meals, late fees, finance charges, and other miscellaneous expenses.

The Oneida Housing Authority's independent auditor identified approximately $100,000 in abusive expenditures in 2006 alone. These expenditures were from local funds which included unrestricted income from 1937 Act units. The abusive expenditures led to the removal of the housing board by the tribe and notification to HUD of the abuses. The abuses included excessive board stipends, excessive travel and lodging costs, excessive per diem payments, payment of hotel costs for days with no business activities, and excessive room and vehicle upgrades.

In contrast, the Salish and Kootenai Housing Authority used unrestricted income from NAHASDA-assisted 1937 Act units to fund low-income housing tax credit properties. Although, its program income system did not follow the guidance to recognize capital improvements funded by NAHASDA, the records existed to correct the system. We did not observe abuses of the revenue from 1937 Act units.

Also, the Southwest ONAP office issued a monitoring report of the Navajo Housing Authority on September 7, 2005. Southwest ONAP reported that unrestricted income from its 1937 Act units was used for what were otherwise ineligible expenditures, including

- $1.9 million for the Cabinets Southwest project (Cabinet plant) and more than $3.7 million for the Flexcrete Building System project (Concrete block manufacturing);

- More than $4.1 million for the Chaco Trails project, a planned community intended for families of all income levels to include housing rentals, property sales, and economic development, which was questioned by Southwest ONAP as an ineligible economic development; and

- $765,435 paid for lobbying expenditures during the period January 2004 through June 2007.

Tribes Allowed to Repay Inappropriate Expenditures Using 1937 Act Rent Revenue

We reviewed additional monitoring reports issued by ONAP but did not identify significant findings related to existing program income guidance. However, we noted that other reports with monetary findings totaling almost $2.2 million were often resolved by repaying grants with revenue from NAHASDA-assisted 1937 Act units. Over $1.4 million of the $2.2 million came from the redirected rent revenues. This ONAP policy allowed housing authorities to use rent from low-income Native Americans to repay the following violations and abuses:

Recipient name and Monitoring report date	Findings and observations
Lower Elwha Housing Authority Dec. 15, 2005	Financial management systems were not adequate, and $31,080 in grant costs was not supported. The authority supported the expenditures except for $2,971 in miscellaneous unallowable expenditures repaid using unrestricted income.
Tulalip Tribes Housing Authority Jan. 6, 2003	Financial management systems were not adequate. The authority reconstructed and supported grant expenditures except for $425,256.02, which was repaid with unrestricted income. Those expenditures were for excessive or abusive payments for travel, stipends, personal expenses, food, entertainment, cell phone charges, and petty cash.
Makah Housing Authority Jan. 27, 2003	Financial management systems were not adequate. The authority reconstructed and supported grant expenditures. The $939,843 in questioned costs was offset by reducing future grants, but $39,550 in paving work for ineligible program participants was repaid with proceeds of sale from 1937 Act housing.
Puyallup Tribe Aug. 19, 2005	The authority's Elder's Preservation Program assisted families who were not eligible to receive NAHASDA funds or families who did not sufficiently demonstrate eligibility. The authority charged $42,613 of these expenditures to unrestricted income but later agreed to reduce its NAHASDA grant amounts because of insufficient unrestricted income.

Recipient name and Monitoring report date	Findings and observations
Quileute Housing Authority Aug. 2, 2002	The authority used at least $365,439 in housing money to finance construction of a day care center. Based on the analysis of the regional ONAP Administrator, this issue was not pursued as a finding since the tribe could hypothetically claim sufficient unrestricted income to cover these costs. Later, the 2008 monitoring review showed that the tribe did not have a system or records to properly calculate unrestricted income.
Yakima Nation Housing Authority (No report issued)	The authority made a retroactive adjustment to 2000 to reclaim unrestricted income previously used to pay the expense of maintaining and operating 1937 Act housing. HUD acknowledged that it would not review or control the use of unrestricted income.
Muscogee (Creek) Nation July 31, 2003	The authority repaid the program from proceeds of sale of 1937 Act properties for $93,501 for consulting contracts to a related party of the approving official, $66,471 in excessive administrative costs, and $24,719 for a passenger van purchased under a drug elimination grant.
Pueblo of Jemez Aug. 22, 2003	The Pueblo of Jemez repaid the program $54,768 from unrestricted income for ineligible expenditures for $21,606 in unrelated college tuition, a $1,377 undocumented purchase, and $7,895 in credit card late fees, tuition, food, and fuel charges. The remaining ineligible costs were not specified.
Te-Moak Tribe Aug. 1, 2005	The authority calculated unrestricted income for 2005 and used it to pay $120,690 in ineligible costs for monthly payments to the board chairperson, attorney fees associated with the tribe's gaming operation, ineligible travel expenses, and other miscellaneous expenses. HUD acknowledged that it would not review or control the use of unrestricted income.
Turtle Mountain Housing Authority Aug. 2, 2000	Financial management systems were not adequate. The authority calculated $700,745 in unrestricted income for 2001 and used it to repay $179,607.50 in development expenses incurred without an environmental review and $114,562.06 for other undocumented expenses.
White Mountain Apache Housing Authority May 27, 2004	The authority calculated unrestricted income for 2006 and used it to pay ineligible costs for $7,735 and $3,442 payments to two individuals and $32,847 for the cost of an election dispute.
Cherokee Nation of Oklahoma June 8, 2007	Environmental reviews were not performed, and restrictions to the deeds of purchased units did not meet requirements. The $506,102 spent for these homes was repaid using proceeds from the sale of 1937 Act units.

Recipient name and Monitoring report date	Findings and observations
Pueblo of Laguna Oct. 29, 2003	Financial management systems were not adequate, and $93,035 in grant costs was ineligible. The authority stated that the expenditures for an ambulance and entertainment/social expenditures were paid using unrestricted income.

Opportunity to Redirect $40 Million in 1937 Act Unit Rent Revenue Annually for Unrestricted Uses

Based on observed practices and guidance in section 3.4 of the notice, ONAP provided tribal housing authorities the opportunity to redirect up to about $40 million a year in rent revenue from NAHASDA-assisted 1937 Act Low Rent program properties. The annual amount allowed to be redirected equals the number of 1937 Act current assisted stock rental units claimed by tribes for 2008 funding times 46 percent of the monthly allowable expense level figure for each tribe as published in the appendix of the notice times 12 months.

ONAP also allowed tribes to retroactively calculate their unrestricted income from their 1937 Act properties back to 1998 and to reprogram these funds for purposes that did not meet the requirements of the NAHASDA program. Thus, as much as $400 million ($40 million times 10 years) in NAHASDA funds could be used to substitute for the redirected revenues from the 1937 Act properties.

Typical Grants Management Controls Were Not In Place

OMB Circular A-123, Management Accountability and Control, revised June 21, 1995, provided the criteria for implementing management controls within the NAHASDA regulations. The following paragraph from Circular A-123 sets the tone for management's responsibilities. See appendix F for additional excerpts from the circular.

> "The proper stewardship of Federal resources is a fundamental responsibility of agency managers and staff. Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Resources must be used consistent with agency mission, in compliance with law and regulation, and with minimal potential for waste, fraud, and mismanagement."

Accordingly, ONAP was responsible for establishing controls to ensure that NAHASDA funds would be used for the purposes and goals stated in the NAHASDA statute. However, ONAP did not institute adequate controls to do so.

Specifically,

- ONAP could have taken more steps to protect affordable housing for low-income Native Americans by restricting rent revenue from NAHASDA-subsidized 1937 Act properties for NAHASDA-related use but, instead, made a management decision to remove restrictions from this income (see appendix B for complete discussion).

- ONAP's guidance on program income did not require housing authorities to match revenues and expenses from NAHASDA-assisted 1937 Act units (see appendix C for complete discussion).

OIG's Responsibility for Reporting Abuse

The auditor's responsibility for reporting such abuse observed during performance audits is explained in sections 7.33, 7.34, and 8.21 of the Government Accountability Office's Government Auditing Standards (GAO-07-731G), July 2007 revision. These sections are attached to this report as appendix G. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances.

Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement.

Conclusion

HUD's program income regulations and ONAP's corresponding guidance found in PIH Notice 2000-18 were ambiguous and inconsistent with the NAHASDA goals to provide funding to assist and promote affordable housing activities for Indian tribes and promote self-sufficiency of Indian tribes and their members. Further, the calculation of program income allowed under the notice was inconsistent with generally accepted accounting principles since it did not provide for the matching of the operating expenses of the rental units against the rental income generated by these units. As a result, the application of these policies allowed tribal housing authorities to redirect and abuse millions of dollars in rent collected from low-income Native Americans living in NAHASDA-assisted 1937 Act units.

ONAP's program income guidance provided tribes the opportunity to redirect up to $40 million per year in rent revenue from NAHASDA-assisted 1937 Act Low Rent program properties. This amount totals about $400 million in NAHASDA-assisted rental revenue that was or is currently available to be retroactively redirected for unrestricted uses. When tribes redirected rent revenue from these 1937 Act properties they effectively reduced assistance available to other low-income Native Americans since the total grant

amount remained the same. While some tribes used these unrestricted funds wisely, the funds were too often wasted and abused rather than used to assist the intended beneficiaries of the program. Since ONAP has permitted retroactive adjustments, additional funds may be redirected in the future.

Recommendations

We recommend that the Deputy Assistant Secretary, Office of Native American Programs,

1A Take immediate action to ensure the correct matching of total revenues with total expenses in tribal housing authority's future calculations of net income and the subsequent attribution of program income.

1B Rescind PIH Notice 2000-18 and associated program guidance, such as Program Guidance Memorandums 2001-3T and 2002-12, until appropriate guidance can be designed that conforms with generally accepted accounting principles and supports the purpose and goals of NAHASDA.

1C Suspend the restatement of tribal records for the purpose of redirecting prior period revenue from NAHASDA-assisted 1937 Act units unless all costs for operation, maintenance, rehabilitation, and capital improvement have been reimbursed by offsetting expenses against revenue of those units in a method consistent with self-sufficiency.

SCOPE AND METHODOLOGY

Our objective was to determine whether ONAP's guidance on calculating program income for the NAHASDA-assisted 1937 Act housing projects complied with NAHASDA, implementing regulations found in 24 CFR 1000.62, and external requirements such as OMB Circular A-87 and generally accepted accounting principles. The audit steps were designed to provide an understanding of the accounting for program income from 1937 Act-assisted properties and the requirements affecting development of policy and guidance.

To accomplish our objectives, we reviewed ONAP criteria and guidance to calculate program income from NAHASDA-assisted 1937 Act housing projects and related supporting documentation at its offices in Denver, Colorado, and Washington, DC. We compared these criteria to the actual practices observed in resolution of Audit Report 2005-SE-1001 of the Tulalip Housing Authority in Marysville, Washington, dated October 21, 2004.

We then reviewed a sufficient number of tribal housing authority cost accounting systems to confirm whether those accounting systems were capable of tracking modernization and capital expenditures at the housing unit level if the tribes chose to redirect unrestricted income. We also reviewed their systems to track the transition of units from a 1937 Act identity to a NAHASDA identity. Finally, we observed the use of income generated from NAHASDA-assisted 1937 Act units.

We selected for review four tribal housing authorities, covering program income calculations and records through 2006. Of the 30,701 NAHASDA-assisted 1937 Act housing units nationwide, we selected a diverse group of housing authorities representing 7,354 NAHASDA-assisted 1937 Act rental and homeownership units, covering a full range of economic opportunity and administrative capability.

Housing authority	Location	Audit report no.	Issue date
Warm Springs	Warm Springs, OR	2008-SE-1001	Oct. 30 2007
Oneida	Oneida, WI	2008-SE-1002	Feb. 20, 2008
Salish & Kootenai	Pablo, MT	2008-SE-1003	Apr. 28, 2008
Navajo	Window Rock, AZ	Southwest ONAP Monitoring Report	Sept. 7, 2005

The tribes included the Navajo Nation, the largest tribe in the country, and the Salish & Kootenai Nation, which participated in writing the program income guidance in PIH Notice 2000-18. Both housing authorities are well represented in Native American housing organizations and within ONAP. The remaining two tribes encountered management control problems at their housing authorities and took action to regain control of housing operations.

The audit work was conducted between September 26, 2006, and July 3, 2008. Our review covered the period October 1, 1997, to December 31, 2006, which corresponds to the effective date of the NAHASDA program through the latest calendar year of operations available for audit at the tribal housing authorities. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, 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.

Relevant Internal Controls

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

- Program management's policies to oversee NAHASDA grantees' activities to carry out the purpose and goals of NAHASDA and its administrative capacity to provide the proper stewardship of federal resources.

- Policies and procedures that HUD has in place to reasonably ensure implementation of HUD directives according to relevant requirements.

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:

- ONAP's policies did not always ensure that tribal resources were fully used to assist and promote affordable housing activities to develop, maintain, and operate affordable housing in safe and healthy environments. It supported a tribe's ability to use revenue from low-income housing programs for any other purpose, without restrictions, even when grant funds must be used to fund operations, maintenance, rehabilitation, or capital improvements. When used by the tribes, this practice reduces housing opportunities for low-income Native Americans.

- ONAP did not create adequate guidance for the determination of program income from NAHASDA grants. The guidance created was known to be unclear before approval and issuance and resulted in significant abuse. ONAP issued a number of clarifications to its program income guidance to support an interpretation that allowed rent revenue from NAHASDA-assisted low-income housing to be redirected. The abuses observed as a result of this guidance run counter to NAHASDA's goals and the plain meaning of 24 CFR 1000.62. Moreover, the practice is inconsistent with the proper matching of revenues and expenses under generally accepted accounting principles. The guidance provided the maximum unrestricted funds to tribes, thereby reducing funds available for the stated purpose and goals of NAHASDA and drawing into question the enforceability of ONAP criteria.

APPENDIXES

Appendix A

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-5000

DEC 22 2008

OFFICE OF PUBLIC AND INDIAN HOUSING

MEMORANDUM FOR: Joan S. Hobbs, Regional Inspector General for Audit, 9DGA

FROM: Rodger J. Boyd, Deputy Assistant Secretary for Native American Programs, PN

SUBJECT: Comments on the Draft Audit Report: NAHASDA Program Income from 1937 Act Properties

This memorandum provides formal, written comments on the subject draft audit report.

Comment 1

The Office of Native American Programs (ONAP) disagrees with the draft audit report in its entirety. There is no basis for the sole finding in the audit report, other than the Office of Inspector General's (OIG) disagreement with the negotiated policies and requirements reflected in the Indian Housing Block Grant (IHBG) program income regulation and Notice.

Comment 2

The IHBG regulations are a product of negotiated rulemaking between the Department and tribal representatives pursuant to the Native American Housing Assistance and Self-Determination Act (NAHASDA). NAHASDA required negotiated rulemaking to foster Indian self-determination and further the government-to-government relationship between the Federal Government and sovereign Indian nations. All parties involved in the rulemaking acted in good faith to develop regulations that reflected the requirements, objectives, and purposes of NAHASDA. Assertions in the draft report to the contrary are unfounded.

Comment 3
Comment 4

The sole finding in the draft report is based on the conclusion that the regulation is ambiguous and the program income guidance is not consistent with generally accepted accounting principles. The OIG, throughout the external and internal audit processes, has tried to make IHBG program income an accounting matter, even though the requirements for program income are based on NAHASDA and the implementing negotiated regulations.

Comment 5

The negotiated regulations (proposed and final) and PIH Notice 2000-18 went through the required Departmental clearance process. The final negotiated rule was published March 12, 1998, and the Notice was issued May 30, 2000. The OIG had the opportunity during clearance to comment or object to the policies and requirements of the regulations or Notice. In addition, the Office of Management and Budget cleared the regulations and would have objected to any provisions that were in conflict with its own cost principles circular. Waiting until now to object to negotiated decisions in the regulations and Notice that have been in effect for 8 to 10 years is not appropriate.

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Comment 6

Comment 7

Comment 8

Comment 9

Comment 10

During the negotiated rulemaking process and subsequent development of the program income Notice by HUD and tribal representatives, the Office of General Counsel provided legal advice concerning the interpretation of NAHASDA and regulations. (The then-Associate General Counsel participated in the negotiated rulemaking and on the program income workgroup.) The regulation and program income Notice were based upon legal advice that: (1) income from rental housing developed under the United States Housing Act of 1937 (the 1937 Act units) is not subject to any requirements unless the units were assisted with IHBG funds and the income was attributable to the grant funds, and (2) NAHASDA does not limit the amount of grant funds that may be used for operating assistance for 1937 Act units. To the extent that generally accepted accounting principles address the accounting of revenue against costs, these principles cannot be invoked to impose requirements on the use of revenue from the 1937 Act units (in contravention of the regulation), or to limit the use of IHBG funds for operating assistance (in contravention of NAHASDA).

The report contains many inflammatory words and statements, such as characterizing as "skimming" the use of rent revenues that are not subject to any Federal requirements (pages 26 & 30 (subsequently removed in the second version of the draft report, after ONAP objected)). In addition, the description of "Significant Weaknesses" on pages 21 & 22 shows the OIG's jaundiced view of Indian tribal leaders and ONAP. For example, the first and second sentences of the first bullet, which are the essence of the accusation, stated: "ONAP did not always assist and promote housing activities to develop, maintain, and operate affordable housing in safe and healthy environments. It chose the desires of tribal leaders over the needs of low-income Native Americans." (This language was revised slightly in the second version of the draft report, after ONAP objected.) This is a total distortion of the negotiated rulemaking process, and implies that elected tribal leaders do not care about their tribal members, that they have personal agendas that operate to the detriment of their constituents, and that ONAP is complicit in working with them and against the best interests of low-income Native American families.

SPECIFIC COMMENTS ON THE DRAFT REPORT

Comment 11

Highlights -- page 1

The objectives of the audit are faulty. The first stated objective was to "determine whether ONAP's guidance on calculating program income for the NAHASDA-assisted 1937 Act housing projects was consistent with generally accepted accounting principles." As stated above, to the extent that generally accepted accounting principles address the **accounting** of revenue against costs, these principles cannot be invoked to impose requirements on the use of revenue from the 1937 Act units (in contravention of the regulation), or to limit the use of IHBG funds for operating assistance (in contravention of the statute).

Comment 8

Comment 12

The second objective was "to determine whether the effects of implementing this guidance were consistent with the purpose and goals of NAHASDA." Because the tribal/HUD working group developed the guidance based on legal advice that construed the requirements of NAHASDA, and because the effects are consistent with the legal advice and requirements, there is no basis

for the report to conclude the guidance resulted in an effect that was not consistent with the purpose and goals of NAHASDA.

What We Found -- page 2

Comment 13

The audit report does not acknowledge that the negotiated program income regulation is the basis for the PIH Notice. The program income requirements and policies are set forth in the regulation at 24 CFR 1000.62. This regulation states: "Program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance." These funds are not subject to any Federal requirement and accordingly, there is no basis for the report to say the funds were "redirected" and "abused," or otherwise conclude that the use of the funds violated any Federal requirement, or that the use was inconsistent with any requirement, purpose, or goal.

Comments 2 and 3

The report tries to say that the guidance is the problem. It is not. The program income Notice (PIH Notice 2000-18) addresses the negotiated regulation language of when "the income [from the operation of 1937 Act rental units] is attributable to such assistance." The regulation clearly provides that not all the income is program income, which is subject to IHBG requirements.

What We Recommend – page 2

Comment 3

ONAP disagrees with the finding and accordingly, disagrees that any action is needed. Moreover, any revision suggested by the audit report would require an amendment to the IHBG regulation through negotiated rulemaking.

BACKGROUND AND OBJECTIVES

Previous Assistance under the 1937 Act – page 4

Comment 14

The discussion contains inaccuracies. Under the United States Housing Act of 1937, grants were made to Indian Housing Authorities, not to "Native American tribes." The statement regarding program income terminology is a nonsequitur.

NAHASDA's Negotiated Rulemaking – page 5

Comment 15

The first sentence does not apply to negotiated rulemaking; it addresses transition requirements. Therefore, the citation should be 106(a), and its inclusion is inconsistent with the paragraph heading.

Comment 16

The sentences dealing with the *Seattle Times* report and issues in Native American housing had nothing to do with program income. The reported abuses under the 1937 Act program were due to costs limits for an entire project, rather than for individual housing units.

Comment 17

This section fails to acknowledge that the Native American Housing Assistance and Self-Determination Act, and the IHBG program, are rooted in Indian self-determination. The negotiated rulemaking involved the government-to-government relationship between HUD and the Indian tribes to develop regulations governing the IHBG program in accordance with the purposes and goals of NAHASDA. The Indian tribes have the responsibility for deciding how to spend their block grant funds.

Our Objective – page 5
See comment above under "Highlights."

RESULTS OF AUDIT
Finding 1 – page 6

Comment 18
ONAP disagrees with the finding. The audit report describes the regulation as "ambiguous." It also declares that the guidance documents were not consistent with generally accepted accounting principles. These assertions are incorrect. Moreover, the OIG had its opportunity to raise any objections during the Departmental clearance process 10 years ago.

Comment 19
The negotiated rule, based on legal advice, states that income from the operation of 1937 Act rental units is not program income (and therefore is not subject to any Federal requirement), unless the 1937 Act units are assisted with grant funds and the income is attributable to such assistance. The regulation does not define "attributable." The task of providing guidance was left by the negotiated rulemaking committee to a special program income workgroup whose tribal members were appointed by the co-chairs of the negotiated rulemaking committee. (See preamble discussion to the final rule at 63 FR 12338 (March 12, 1998).)

Comment 20
The program income Notice (PIH Notice 2000-18) provides comprehensive guidance on IHBG program income. Among other topics, it specifically addresses the regulatory language of when "the income [from the operation of 1937 Act rental units] is attributable to such assistance." The regulation clearly provides that not all the income is program income, which is subject to IHBG requirements. The regulation and Notice were premised upon legal advice from the Office of General Counsel that (1) income from the 1937 Act units is not subject to any requirements unless the units were assisted with IHBG funds and the income was attributable to the grant funds, and (2) NAHASDA does not limit the amount of grant funds that may be used for operating assistance for 1937 Act units.

Comment 8
As discussed above, accounting principles cannot impose requirements that are inconsistent with the governing program statute and regulations. Accordingly, the principle for accounting revenue against costs does not apply in a matter that dictates the use of rent revenue from 1937 Act units, and does not control the amount of IHBG funds that may be used for operating assistance for 1937 Act rental units.

Comment 21
Under the negotiated regulation, rent revenue that is not program income is not subject to any Federal requirement. Accordingly, this rent was not redirected or abused because it is not subject to any Federal requirement.

HUD's Implementation of NAHASDA – page 6

Comment 22
Comment 23
The description in the first and second paragraphs is incorrect. The first paragraph is not relevant to the subject of program income. See attached legal opinion dated April 30, 2007. The second paragraph is incorrect in describing the formula block grant, and fails to recognize the obligation under section 203(b) of NAHASDA.

Comment 24

The last sentence on page 6, continuing on page 7, incorrectly restates the regulation. The regulation does not state when income is generated; it addresses how much income is program income (i.e., the income attributable to the grant assistance).

Development of Program Income Rules and Guidance – page 7

The discussion of negotiated rulemaking committee notes and quoted language are irrelevant to the issue presented by this draft audit report. There is no apparent connection to the finding.

Comment 25

Tribes Allowed to Redirect Rent Revenues from Assisted Units – page 8

PIH Notice 2000-18 was issued May 30, 2000, after Departmental clearance. OIG had an opportunity to review the Notice and provide nonconcurrence comments during the clearance process. It is untimely for OIG to object to any provision in the Notice more than 8 years after the Notice was issued.

This section again tries to impose requirements on income that is not subject to any Federal requirement and mischaracterizes the use of the income as "redirected" rent revenue.

Comment 26

The chart on page 9 is biased and misleading. There is no profit involved in this type of housing; housing authorities are non-profit organizations. Moreover, the chart does not reflect the decision-making that is inherent to the IHBG recipient under NAHASDA on the use of its block grant funds.

Program Income Guidance Was in Conflict with NAHASDA Goals and Generally Accepted Accounting Principles – pages 9-11

There is no basis for this section.

Comment 25

PIH Notice 2000-18 was issued May 30, 2000, after Departmental clearance. The OIG had an opportunity to review the Notice and provide any nonconcurrence comments during the clearance process. It is untimely for OIG to object to any provision in the Notice more than 8 years after the Notice was issued.

The draft audit report incorrectly characterizes the Notice as creating "an unnecessary obligation for the government." The governing statute does not limit the amount of grants funds that may be used for operating assistance. The amount of IHBG funds that an Indian tribe or its recipient decides to use for operating assistance—or for any eligible activity—does not affect the amount of its formula grant.

Comment 8

The Notice is not inconsistent with "fundamentals of accounting," as discussed above. Accounting principles cannot impose requirements that are inconsistent with the governing program statute and regulations. The accounting principle cited does not apply in a matter that dictates the use of rent revenue from 1937 Act units, and does not control the amount of IHBG funds that may be used for operating assistance for 1937 Act rental units.

Comment 27

The provision in OMB Circular A-87 on depreciation and use allowance is not applicable. NAHASDA sets forth the eligible use of IHBG funds. The grant funds are not being used for depreciation or use allowance; they are used for operating assistance.

Comment 6

The Notice is legally supportable, as described in the attached legal opinion to the Regional Inspector General dated April 30, 2007.

Comment 21

1937 Act Unit Rent Revenue Was Used for Wasteful or Abusive Expenditures – pages 11-13

Rent revenue that is not program income is not subject to any Federal requirement. Accordingly, there are no Federal restrictions on the use of the funds, and the use of this revenue cannot be characterized as wasteful or abusive.

Comment 25

Tribes Allowed to Repay Inappropriate Expenditures Using 1937 Act Rent Revenue – pages 13-14

Rent revenue that is not program income is not subject to any Federal requirement. Accordingly, there are no Federal restrictions on the use of the funds, including the uses listed in the report. Again, the auditors disagree with the policy and requirements in the negotiated program income regulation and Notice, but failed to object during the Departmental clearance process.

Comment 25

Opportunity to Redirect $40 Million in 1937 Act Rent Revenue Annually for Unrestricted Uses – page 15

This section again fails to acknowledge that the negotiated regulation established the policies and requirements for program income. Again, the OIG disagrees with the policy and requirements in the negotiated program income regulation and Notice, but failed to object during the Departmental clearance process.

Comment 28

Typical Grants Management Controls Were Not In Place – page 16

ONAP established controls that are consistent with the regulations. There is no basis for the assertions in this section; this is merely an unsuccessful attempt by the OIG to recast the policy disagreement.

Comment 29

OIG's Responsibility for Reporting Abuse – page 16

The OIG's policy disagreement with the IHBG program income negotiated rule does not provide the basis for the audit report's assertion of "abuse" as defined in Appendix G, because the rent revenue in question is not program income and is not subject to any Federal requirement.

Conclusion – page 17

This section summarizes previous pages in this draft report. ONAP disagrees for the reasons stated above.

Comment 30

Recommendations – pages 17-18

ONAP disagrees with the finding. Accordingly, no action to address the finding is required. Moreover, because the policy to which the OIG objects is embodied in the regulation, action to change the policy requires negotiated rulemaking in accordance with NAHASDA.

Comment 31

SCOPE AND METHODOLOGY – pages 19-20
The inclusion of the Navajo Housing Authority is not consistent with the stated scope and methodology. The chart indicates the issue date of the Navajo monitoring report was September 7, 2005. The paragraph above the chart states: "We selected for review four tribal housing authorities, covering program income calculations and records through 2006." Because the Navajo monitoring report was issued September 7, 2005, it could not cover program income calculations and records through 2006.

In addition, the paragraph on page 20 says the audit work was conducted between September 26, 2006 and July 3, 2008. Clearly this is not true of the Navajo monitoring report, which was issued September 7, 2005.

Comment 32

ONAP disagrees that audits of three IHBG recipients is a sufficient sample. However, ONAP believes that the number of audits is immaterial to this report because the sole dispute is the OIG's disagreement with the policy and requirements in the negotiated rulemaking, to which the OIG did not object during Departmental clearance.

INTERNAL CONTROLS – pages 21-22
Not only does the audit report fail to acknowledge that the sole issue is OIG's disagreement with the policy and requirements in the negotiated rule on program income, it accuses ONAP and tribal leaders of bad faith. Moreover, it describes these inflammatory assertions as "Significant Weaknesses" in internal controls.

Comment 33

The first "Significant Weakness" stated: "ONAP did not always assist and promote housing activities to develop, maintain, and operate affordable housing in safe and healthy environments. It chose the desires of tribal leaders over the needs of low-income Native Americans." (This language was revised slightly in the second version of the draft report, after ONAP objected.) This is a total distortion of the negotiated rulemaking process, and implies that elected tribal leaders do not care about their tribal members, that they have personal agendas which operate to the detriment of their constituents, and that ONAP is complicit in working with them and against the best interests of low-income Native American families.

The second "Significant Weakness" states (second sentence): "The guidance created was known to be unclear before approval and issuance and resulted in significant abuse." Nothwithstanding this unfounded assertion, the OIG did not object to the Notice during Departmental clearance and is only now criticizing the Notice more than 8 years after issuance.

Comment 34

Appendix B – page 25
This section is incorrect. It misstates the requirements, as well as the legal opinion provided by the Office of General Counsel. Notwithstanding that the OIG sought and received a legal opinion from the Office of General Counsel, the OIG continues to expound its incorrect legal interpretation of the requirements. See the attached legal opinion dated April 30, 2007.

Appendix C – pages 26- 28

Comment 34

This appendix is the auditors attempt to again re-frame their disagreement with the policy as inconsistent with their personal views of the statute. This appendix is wrong in asserting that the program income guidance was inconsistent with NAHASDA and the regulations. The Office of General Counsel participated in the negotiated rulemaking and in the workgroup that developed the program income guidance. ONAP and tribal representatives were provided legal advice on program income. The regulation and the Notice are consistent with the legal advice. Every time the auditors have asserted their own legal interpretation in connection with program income audits, OGC has been asked and has provided a written legal opinion that supports the program regulation and Notice. See attached legal opinions dated April 30, 2007, June 27, 2008, August 4, 2008, and September 29, 2008. The OIG continues to disagree with the extensive legal advice provided.

Comment 9

The appendix also demonstrates the OIG's bias regarding IHBG program income. The last sentence in the second paragraph on page 26 used the word "skimmed" (subsequently changed to 'redirected' in the second version of the draft report, after ONAP objected) to describe actions that are permitted by the regulation and statute. Consistent with NAHASDA, the IHBG negotiated regulation provides that rental income from 1937 Act units is not program income unless the units are assisted with IHBG funds, and the income is attributable to the assistance. Rental income that is not program income is not subject to any Federal requirement.

Comment 8

Comment 35

This appendix misstates the legal advice and continues to assert that accounting principles dictate the use of rental income. The draft audit report does not recognize that the permissible uses of rental income and grant funds are based on the statute and regulations, not on accounting conventions. As stated above, the regulation and program income Notice were negotiated based upon legal advice that: (1) income from rental housing developed under the United States Housing Act of 1937 is not subject to any requirements unless the units were assisted with IHBG funds and the income was attributable to the grant funds, and (2) NAHASDA does not limit the amount of grant funds that may be used for operating assistance for 1937 Act units. To the extent that generally accepted accounting principles address the accounting of revenue against costs, these principles cannot be invoked to impose requirements on the use of revenue from the 1937 Act units (in contravention of the regulation), or to limit the use of IHBG funds for operating assistance (in contravention of NAHASDA).

Comment 36

Appendix H – pages 40- 41 (Appendix added in the second version of the draft report)
Most, if not all, of the items identified in this chart have previously been identified through monitoring by ONAP staff. The OIG's objection to these activities appears to be based on the use of non-federal funds to repay debt owed to the government.

Attachments

Comment 6

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

April 30, 2007

MEMORANDUM FOR: Joan S. Hobbs, Regional IG for Audit, Regions IX and X

FROM: Robert S. Kenison, Associate General Counsel,
Office of Assisted Housing and Community Development, CD

SUBJECT: Program Income under the Native American Housing Assistance and Self-Determination Act

This responds to your request for a legal opinion concerning program income under the Native American Housing Assistance and Self-Determination Act (NAHASDA) as well as income associated with Indian housing constructed under the United States Housing Act of 1937 (the 1937 Act). Your senior auditor, John Melgaard, is auditing program income from 1937 Act properties assisted with NAHASDA funds. Of particular interest to him is the treatment of rental receipts from 1937 Act Low Rent properties assisted with NAHASDA funds. Mr. Melgaard is asking OGC to represent whether the Office of Native American Programs (ONAP) policies complied with the statute and other requirements.

NAHASDA terminated funding for Indian housing to Indian housing authorities under the 1937 Act and consolidated funding through an annual formula housing block grant to Indian tribes. Section 106(a) of NAHASDA required HUD to establish any requirements necessary to provide for the transition from the 1937 Act program to the new funding under NAHASDA. 25 USC § 4116(a). The transition requirements were required to be published as a notice in the Federal Register for comment. The statute further required negotiated rulemaking for regulations to implement NAHASDA, taking into account the unique government-to-government relationship between Indian tribes and the United States, and ensuring that the rulemaking committee included only representatives of the Federal Government and of geographically diverse small, medium, and large Indian tribes. 25 USC § 4116(b)(2).

Before the promulgation of regulations governing the transition from 1937 Act funding to NAHASDA grants, ONAP issued a transition notice in the Federal Register on January 27, 1997 (62 FR 3971). That notice was silent on the use of proceeds from the sale of Mutual Help (homeownership) units constructed under the 1937 Act. HUD subsequently received questions about this issue. In November 1998, I advised ONAP that proceeds from the sale of Mutual Help units were not subject to any requirement, except existing Mutual Help administrative use agreements, if any. I advised that it was ONAP's policy decision whether to administratively impose requirements. The analysis and background were set forth in a short note to then-General Counsel Gail Laster, to

apprise her of the legal issue and alert her to other considerations. The 1937 Act did not require administrative use agreements -that was a policy decision - and NAHASDA does not address the issue of proceeds from the disposition of 1937 Act units. Under the Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments, codified for HUD programs at 24 CFR Part 85, there are no Federal requirements governing the disposition of program income earned after the end of the award period, unless the terms of the agreement or Federal agency regulations provide otherwise (§85.25(h)).

Consistent with my legal advice, ONAP revised the transition notice and published additional questions and answers in the Federal Register on April 1, 1999 (64 FR 15778). The transition notice provides that proceeds from the sale of homeownership units can be used for any housing activity, community facility or economic development activity that benefits the community. The notice also provided that any existing administrative use agreement could be terminated at the request of the Indian housing authority or successor entity.

The issue of income from rental units constructed with 1937 Act funds arose late in the final negotiated rulemaking session, in which I participated. The regulation at 24 CFR § 1000.62(a) states "Program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with [NAHASDA] grant amounts and the income is attributable to such assistance." I believe now, as I did at the time this regulation was promulgated, that this regulation and ONAP's implementation of it comport with all applicable laws and regulations. Any issue concerning this regulation, including possible criticism about the unrestricted use of funds generated from the operation of 1937 Act units, should have been raised during negotiated rulemaking, HUD clearance of the final regulation, or OMB review. No objection was timely made.

A workgroup of tribal and HUD representatives was given the task to develop guidance on the regulation. I participated in the workgroup. Bob Gauthier (representing Salish Kootenai) and I suggested the use of a percentage of the Allowable Expense Level (AEL) to represent the amount of rent that 1937 Act units were generating at the time of the effective date of NAHASDA. This methodology was legally supportable based on HUD data showing the average rents received by the Indian housing authorities to be 46% of the AEL. This surrogate was reasonable and relieved the recipients of the burden of demonstrating the actual rents received for each rental unit at the effective date of NAHASDA. Notice PIH 2000-18 Accounting for Program Income under the Native American Housing Assistance and Self-Determination Act (NAHASDA) sets forth the policy developed by the workgroup.

When looking at the issue of costs incident to the generation of program income, § 1000.62(d) must not be read to render the definition in § 1000.62(a) meaningless. Under § 1000.62(a), income attributable to the 1937 Act rental units is not program income; only income attributable to the NAHASDA funding in the unit is program income. Section 1000.62(d) states: "Costs incident to the generation of program income shall be deducted from gross income to determine program income." Accordingly, first, the amount of

income attributable to the IHBG program must be determined (actual income minus 46% of AEL) before netting the cost.

The regulatory requirement for deducting the costs is more than accounting instructions; deducting the cost means the income must be used to pay the cost. However, in the case of 1937 Act NAHASDA-assisted rental housing, the result is the same if the operating costs are netted from NAHASDA program income or if NAHASDA program income is not netted and grant funds are used to pay the costs because the operating costs are statutorily eligible to be paid from program income or grant funds.

Under section 202(1) of NAHASDA, grant funds are eligible to be used for operating costs of 1937 Act rental units. 25 USC § 4132(1). Under section 104(a)(1), program income can also be used for any eligible activity. 25 USC § 4114(a)(1). The statute governs the eligible use of grant funds and program income, not OMB Circular A-87. The incoming request has not raised the issue of whether the amount of the costs charged for operations is reasonable; Mr. Melgaard's objection is based on a tribe's discretion not to use its unrestricted income from the 1937 Act units to pay operating costs. However, the use of NAHASDA grant funds to pay operating costs is not dependent on other possible sources to pay the cost. The tribes are not required to use income attributable to the 1937 Act units to pay operating costs and they may use grant funds to pay these costs.

Comment 6

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

June 27, 2008

MEMORANDUM FOR: Rodger J. Boyd, Deputy Assistant Secretary for Native American Programs, PN

FROM: Elton J. Lester, Associate General Counsel for Assisted Housing and Community Development, CD

SUBJECT: Warm Springs Housing Authority IG Audit: Indian Housing Block Grant Program Income – Remedies and Treatment of Comprehensive Improvement Assistance Program Funds

This is in response to your request for a legal opinion in connection with the audit of the Warm Springs Housing Authority (the "Authority" or "Warm Springs") accounting of program income under the Indian Housing Block Grant (IHBG) program. The audit report, dated October 30, 2007, in particular, examined program income from IHBG-assisted housing units developed under the United States Housing Act of 1937 (1937 Act units) and found "The Authority could not properly account for NAHASDA [Native American Housing Assistance and Self-Determination Act] program income" (Finding 1). The report recommended that HUD require the Authority to:

> Establish an accounting system that allocates income attributable to the NAHASDA program and documents the total cost of NAHASDA-funded rehabilitation and capital improvements, by 1937 Act unit, from 1998 forward or return $1.4 million, which was previously withdrawn from 1937 Act revenue as nonprogram income, to the NAHASDA program [Recommendation 1A].

The second part of the recommendation was based on language in Office of Native American Programs (ONAP) Guidance No. 2002-12 (July 9, 2002). You have requested a legal opinion on the enforceability of a statement found at the bottom of page 1 in the guidance, specifically:

> **General Information Related to the OIG Audit:**
>
> In the absence of an accounting system to allocate income attributable to the 1937 Act and the IHBG program, all income (net costs paid for by income and subject to $25,000 exclusion) would be program income and must be used for NAHASDA-eligible affordable housing in accordance with section 202 of NAHASDA.

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This guidance relates to the requirements of 24 CFR 1000.62 "What is considered program income and what restrictions are there on its use?" The audit focused on the second sentence in paragraph (a): "Program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance." ONAP issued PIH Notice 2000-18 giving guidance on program income including income generated from 1937 Act units. In addition, ONAP provided the above quoted ONAP Guidance No. 2002-12.

First, we note that ONAP Guidance No. 2002-12 was informal guidance (not a PIH Notice) and therefore cannot be read to impose a new requirement. Guidance documents are promulgated to assist in the interpretation of existing requirements. This guidance essentially reminds the recipient that it must have a financial management system (required by the IHBG regulation at 24 CFR 1000.26, incorporating the requirements of 24 CFR 85.20) to be able to distinguish between program income and nonprogram income generated by IHBG-assisted 1937 Act units. HUD could not point to this sentence to cite a requirement. That would not be appropriate use of this type of informal guidance.

The recommendations in the audit report do not relate to the statutory remedies under NAHASDA. Under title IV of NAHASDA, sanctions may be imposed for substantial noncompliance with program requirements. The sanctions are generally limited to terminating payments, reducing payments, or limiting the availability of payments under NAHASDA, after HUD has provided reasonable notice and opportunity for a hearing to the recipient. HUD may also provide technical assistance and require a performance agreement if the substantial noncompliance is due to the limited capability or capacity of the recipient. HUD does not have the statutory remedy of requiring all income to be treated as program income if the recipient does not have an accounting system for program income.

The actions proposed in Recommendation 1A are voluntary corrective actions under §1000.530(a) that ONAP may decide are or are not appropriate to seek, taking in account whether the actions will prevent the continuance of the performance problem, mitigate any adverse effects or consequences of the performance problem, or prevent a recurrence of the same or similar performance problem. When ONAP agrees to seek voluntary compliance remedies set forth in audit recommendations, ONAP must take into consideration the recipient's response (i.e., whether the recipient is willing to voluntarily correct the problem) and the statutory sanctions ONAP would pursue if the recipient does not voluntarily comply.

Warm Springs' response to the audit report (Appendix B, Comment 2) indicates that it does not agree that all income must be treated as program income. If ONAP agrees with Recommendation 1A, it must be prepared to pursue statutory sanctions – reducing payments under NAHASDA – through the Enforcement Center. HUD would have to prove to an administrative law judge how much money was spent that was subject to IHBG requirements, but did not meet the requirements. (Finding 1 in the audit report sets forth a problem, rather than a specific violation of the statute or regulation.) HUD must make a case for determining the amount of income that is subject to IHBG requirements (i.e., program income) by using a reasonable process to allocate IHBG rehabilitation costs to each 1937 Act unit, then determine how much income is attributable to

the use of IHBG funds. ONAP has proposed exactly this in its management decision for Recommendation 1A.

CIAP Funds

Since you requested this opinion, the Inspector General has raised an issue regarding Comprehensive Improvement Assistance Program (CIAP) funds received by Warms Springs under the United States Housing Act of 1937 that were not obligated on the effective date of NAHASDA. Section 210 of NAHASDA – "Continued Use of Amounts for Affordable Housing" -- provides: "Any funds for programs for low-income housing under the United States Housing Act of 1937 that, on the date of the applicability of this Act to an Indian tribe, are owned by, or in the possession or under the control of, the Indian housing authority for the tribe, including all reserves not otherwise obligated, shall be considered assistance under this Act and subject to the provisions of this Act relating to use of such assistance." The Inspector General interprets this language to require Warm Springs' CIAP funds to be counted as IHBG funds under the program income regulation.

Section 210 was implemented through the notices for the transition from 1937 Act to NAHASDA funding. HUD was required by section 106(a) of NAHASDA to establish requirements for the transition and to publish the notice of requirements in the Federal Register for public comment. The revised notice of transition requirements published January 27, 1998 permitted unobligated 1937 Act funds to be used for the original purpose or for any eligible activity under NAHASDA. (The uses of funds under the 1937 Act are eligible activities under NAHASDA.) The transition notice provides that if the 1937 Act funds were used in accordance with the requirements for the 1937 Act program, the grant was closed out in accordance with the requirements and procedures for the 1937 Act program. If the funds were used for a NAHASDA eligible activity, the grants would be closed out in accordance with close-out procedures established for NAHASDA.

The transition notice was written before program income requirements were negotiated in a final IHBG regulation and do not address program income. ONAP followed the distinction in the transition notice to determine whether the CIAP grants to Warm Springs should be considered to be "grant amounts" within the meaning of §1000.62. ONAP determined that the two CIAP grants were implemented as CIAP projects and closed in accordance with CIAP requirements. Accordingly, the CIAP grants were not considered to be IHBG grants for program income determinations.

We believe ONAP's interpretation, consistent with the transition notice, is legally supportable and the language of section 210 of NAHASDA does not dictate the interpretation offered by the Inspector General. Indeed, IHBG recipients would have no notice of this new interpretation offered by the Inspector General and it would be arbitrary for HUD to pursue this interpretation ten years after the transition notice was published and eight years after the PIH Notice 2000-18 was issued.

The title of section 210, "Continued Use of Amounts for Affordable Housing," makes clear that the section is about giving IHBG recipients flexibility to use unobligated 1937 Act funds for the eligible affordable housing uses in NAHASDA, not just the limited uses under the 1937 Act. The statute addresses unobligated funds so as not to interfere with existing Indian housing authority

contracts covering the 1937 Act funds, particularly because NAHASDA put control of the IHBG funding in the Indian tribes, rather than the housing authorities. Section 210 does not expressly address program income and does not require unobligated funds to be considered IHBG grant amounts for purposes of the IHBG program income regulation.

Please contact Kathy Bialas (x 5276), Marion McFadden (x 5270), or me (x 5280) if you need anything else from our office related to this matter.

Comment 6

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

August 4, 2008

MEMORANDUM FOR: Rodger J. Boyd, Deputy Assistant Secretary for Native American Programs, PN

FROM: Elton J. Lester, Associate General Counsel for Assisted Housing and Community Development, CD

SUBJECT: Oneida Housing Authority IG Audit: Indian Housing Block Grant Program Income -Treatment of Insurance Proceeds

This is in response to your request for a legal opinion in connection with the audit of the Oneida Housing Authority (the "Authority") accounting of program income for United States Housing Act of 1937 (1937 Act) housing assisted by the Native American Housing Assistance and Self-Determination Act of 1996 (NAHASDA). NAHASDA authorizes funding for the Indian Housing Block Grant (IHBG) program. The audit report contains one broad general finding "The Authority Could Not Properly Account for Block Grant Program Income." The Regional Inspector General for Audit disagrees with the management decision concerning the treatment of insurance proceeds.

The audit report identified one Authority-owned 1937 Act housing unit since the beginning of the IHBG program for which insurance proceeds were received. A claim for fire damage was made in August 2004 and the Authority received $28,000 in insurance proceeds to restore the unit. Under Recommendation 1D, the audit report recommended that HUD: "Require the Authority to reduce the number of 1937 Act units capable of producing nonprogram income by the one unit that received insurance proceeds during 2004, resulting in Block-Grant-funded rehabilitation or capital expenses exceeding 40 percent of the dwelling, construction, and equipment costs."

The management decision concludes that the amount of insurance proceeds used to make the unit whole is not included in determining the amount of IHBG-funded rehabilitation of the unit. The OIG disagrees based on NAHASDA Guidance 2001-03T (October 11, 2000) "Frequently Asked Questions regarding Accounting for Program Income under the Indian Housing Block Grant (IHBG) Program." Question 15 addresses insurance proceeds:

> **Q.15: Are insurance proceeds from an IHBG assisted unit owned by the recipient (e.g., from a house owned by the recipient that was destroyed by a fire) considered program income?**
> A.15: No, insurance proceeds are not considered program income. However, the insurance proceeds from an IHBG assisted unit are considered applicable credits to the

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recipient's IHBG program in accordance with OMB Circular A-87, Section C.4 and must be treated like IHBG funds and used in accordance with NAHASDA requirements. Insurance proceeds from an IHBG assisted unit are considered applicable credits regardless of which funds (IHBG or non-IHBG) were used to purchase the insurance.

The regulatory requirement concerning program income and 1937 Act units is found in the second sentence in 24 CFR 1000.62 (a): "Program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance." The regulation is limited to units assisted with IHBG "grant amounts." The treatment of insurance proceeds as applicable credits to the IHBG program does not make the insurance proceeds "grant amounts" within the meaning of the regulation. The cost principles set forth in OMB Circular A-87 do not trump the language of the regulation. Insurance proceeds are not grant funds and thus do not become part of the calculation for determining when program income is attributable to the use of grant amounts.

Please contact Kathy Bialas (x 5276), Marion McFadden (x 5270), or me (x 5280) if you need anything else from our office related to this matter.

Comment 6

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-0500

OFFICE OF GENERAL COUNSEL

September 29, 2008

MEMORANDUM FOR: Joan S. Hobbs, Regional IG for Audit, Regions IX and X

FROM: Kathleen M. Bialas, Assistant General Counsel for Community Development, CDD

SUBJECT: Clarification on the Legal Opinion concerning the Oneida Housing Authority IG Audit: Indian Housing Block Grant Program Income – Treatment of Insurance Proceeds

This is in response to your request for a clarification of the August 4, 2008 legal opinion. You perceive that there is an inconsistency between that opinion and the opinion dated April 30, 2007 on Program Income under the Native American Housing Assistance and Self-Determination Act. We do not see any inconsistency.

The August 4th opinion states: "Insurance proceeds are not grant funds and thus do not become part of the calculation for determining when program income is attributable to the use of grant amounts." It is clear in the Oneida Audit Report that Indian Housing Block Grant (IHBG) funds were used to purchase the insurance, even though this fact was not re-stated in the opinion. The purchase of insurance with IHBG funds is a cost of operation and maintenance of 1937 Act units. PIH Notice 2000-18 "Accounting for Program Income under the Native American Housing Assistance and Self-Determination Act (NAHASDA)" addresses how much of the income is program income when IHBG funds are used for operation and maintenance. But as stated in the August 4, 2008 opinion, the insurance proceeds are not grant amounts within the meaning of 24 CFR 1000.62(a) and therefore the use of the insurance proceeds to restore the unit is not included in the calculation.

The interpretation of §1000.62 is not based on principles of accounting in OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." The regulation implementing A-87 (2 CFR Part 225) expressly states in §225.20: "This part establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. **The principles are for determining allowable costs only.**" (Emphasis added.)

In summary, by its own terms, A-87 is not relevant to any issue concerning IHBG program income, except the expenditure of program income for allowable costs. There is no inconsistency in the legal opinions regarding IHBG program income.

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OIG Evaluation of Auditee Comments

Comment 1 NAHASDA's Negotiated Rule and the PIH Notice 2000-18, dated May 30, 2000 both state that the revenues from unassisted 1937 Act units are no longer program income, but both criteria require additional analysis and attribution of this revenue when assisted by NAHASDA. (See appendix E) Those criteria do not address the practice of redirecting rent revenue from NAHASDA-assisted 1937 Act units prior to matching expenses with revenue.

The OIG's audit finding of abuse relates to the practice of redirecting rent revenue, whether it originated from informal guidance or was intended by the Negotiated Rule. In instances where former 1937 Act properties receive continued assistance under NAHASDA, the negotiated rule at 24 CFR 1000.62(d) states that "costs shall be deducted from gross income to determine program income." Continuing assistance while allowing tribes to redirect that same property's rent revenue, without deducting expenses, created the opportunity for abuse discussed in this report.

Comment 2 ONAP believes the tribal right to redirect rent revenue from NAHASDA-assisted 1937 Act properties was a policy determined in negotiated rulemaking and is a matter of self-determination. However, the policy relied upon to redirect the rent revenue was first documented after rulemaking and the clearance process for the notice. It was expressed in informal NAHASDA Program Guidance 2001-3T on October 11, 2000:

> **"Frequently Asked Questions:**
>
> Q.1: Can I deduct costs necessary for the generation of program income from gross income to determine program income?
>
> A.1: Yes; you may use the gross income to pay the costs necessary for generating the income and deduct the amount of these costs from gross income to determine program income. You may deduct these costs only if you are using the income to pay these costs."

Comment 3 The policy's inconsistency with generally accepted accounting principles rendered the plain meaning of the NAHASDA regulation at 24 CFR 1000.62(d) ambiguous.

As a result of this ONAP policy, "costs incident to the generation of program income" are no longer required to "be deducted from gross income to determine program income" as stated in the negotiated regulation. Accordingly, a correction to this policy error should not require additional negotiation.

Costs are currently deducted from a preliminary "net income" after first paying the tribes an implied entitlement for NAHASDA's use of 1937 Act government furnished assets, contrary to the restrictions in 2 CFR 225, appendix B, (11)(c).

> c. The computation of depreciation or use allowances will exclude:
>
> (2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides;

Comment 4 The PIH notice contains technical accounting guidance and is therefore an accounting matter. Consider that the title of PIH Notice 2000-18 is "Accounting for Program Income under the Native American Housing Assistance and Self-Determination Act (NAHASDA)."

While ONAP and the OGC do not believe that their accounting policy must comply with generally accepted accounting principles, the accounting policies they constructed have a significant impact on financial report presentation in the areas of restricted and unrestricted assets, and operating and non-operating revenues.

The informal guidance for this accounting policy permits multiple funds per housing unit, allowing removal of NAHASDA-assisted 1937 Act operating revenue from rent, thereby creating non-operating revenue for an authority's unrestricted fund. The policy was first documented in informal guidance issued after negotiated rulemaking and the notice. (See comments 1 and 2)

Comment 5 NAHASDA Program Guidance 2001-3T was not submitted for departmental review to receive concurrence by the OIG and other interested parties. The OIG did not have an opportunity to review this policy, nor did we have this information at the time of negotiated rulemaking or review of the notice so that we could identify or quantify the potential abuse.

While the Office of Management and Budget cleared the regulations, there were no objections to redirecting rent revenue from NAHASDA-assisted units because no such policy was expressed in either the regulation or PIH Notice 2000-18.

Since the regulation and notice both discuss that NAHASDA be attributed program income in return for its assistance and those criteria also require matching of revenues and expenses, there would have been no reason to object to those documents.

Comment 6 ONAP included four legal opinion memorandums with its response defending the legality of their program income accounting policy.

While legal opinions may conclude that certain policies are not an overt violation of the Act or regulation, we are nonetheless responsible for reporting abuses stemming from those policies. The OGC's legal and accounting opinions do not have a bearing on our observation of abuse based on GAO's Government Auditing Standards for reporting abuse. (See appendix G to our report.)

According to the GAO, abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement. However, discussion of OGC's legal and accounting opinions and ONAP's implementation of the guidance serves to demonstrate our understanding of existing controls and those that should be in place to prevent such abuse.

Comment 7 When the then-Associate General Counsel stated an opinion on the restrictions on proceeds of sale of 1937 Act housing, subsequent to negotiated rulemaking, he "determined that the use of proceeds for housing of low income persons was a policy decision, rather than a legal requirement. The situation is akin to the use of program income after the closeout of a grant." The use of program income after the closeout of the 1937 Act grants is addressed by this regulation and program income accounting policy.

The opinion continued that "…HUD might be subject to criticism if the proceeds are not required to be used for housing for low-income Indian families." Proceeds are generated at the same time the government's assistance to these homes ends. However, the 1937 Act rental homes discussed in this audit report may rely upon NAHASDA support indefinitely which presents an additional dimension to the program's risk of abuse.

While we agree with the comments and concerns expressed above by the then-Associate General Counsel, a subordinate was named to the committee generating the program income policy, contrary to ONAP's response. We did not observe similar concerns expressed in subsequent opinions related to non-federal and program income from former 1937 Act rental units.

Comment 8 The accounting principle of matching revenues and expenses complies with NAHASDA negotiated regulations, and the program income accounting notice implementing the policy. In fact, 24 CFR 1000.62(d) mirrors the matching principle. We did not observe any conflict between the generally accepted accounting principles and either the NAHASDA Act or regulation.

Accounting principles do not impose legal requirements on the use of revenue or NAHASDA funds. Rather, they standardize accounting practices used to calculate how much program income exists, in order to prevent redirecting those funds for abusive activities. Calculations based on the regulation and notice place restrictions on the future use of program income. Also, the matching principle does not impose any requirement in contravention of NAHASDA or the Regulation because it is part of the regulation.

However, the ONAP policy, as discussed in Comment 3, appears to not only be the cause of the reported abuse, but contravenes the regulation when it prevents the matching of revenues and expenses to determine program income and renders the plain meaning of 24 CFR 1000.62(d) ambiguous.

Comment 9 As stated in ONAP's response, this language was previously removed at ONAP's request and is not relevant to the final report. We deleted the term "skimming" in favor of "redirecting" to avoid confusion with unauthorized owner distributions under HUD's Multifamily programs, generally referred to as "equity skimming". The term "skimming" itself is neither technically inaccurate nor an implied violation based on common definitions and current NAHASDA rules.

Comment 10 While we removed redundant language from our discussion of internal controls, please refer to pages 11 through 15 of this report for examples of tribal leaders' actions that were inconsistent with the housing needs of low-income Native Americans.

Comment 11 Our audit finding relies upon the GAO standards for reporting abuse (see appendix G). We believe the redirecting of revenue occurred through the misapplication of generally accepted accounting standards. Due to the legal opinions, we are not stating an opinion on compliance with the NAHASDA Act and implementing regulations found in 24 CFR 1000.62, and external requirements, other than the fundamentals of generally accepted accounting principles.

This report and the audit objective are consistent with the Office of Inspector General's mission, which is to:

- Promote the integrity, efficiency, and effectiveness of HUD programs and operations to assist the Department in meeting its mission.
- Detect and prevent waste, fraud, and abuse.
- Seek administrative sanctions, civil recoveries, and/or criminal prosecution of those responsible for waste, fraud, and abuse in HUD programs and operations.

We believe the degree of abuse observed during this audit warrants keeping the Secretary, Congress, and the American public fully and currently informed.

Comment 12 We agree that the guidance was developed consistent with OGC's legal advice. However assessing the resulting abuse against the purpose and goals of NAHASDA is a reasonable objective. Our assessment is consistent with the OIG mission discussed in comment 11. As discussed in comment 7, we did not observe consideration for potential abuses during the development of the guidance or in the supporting legal opinions.

Comment 13 The negotiated program income regulation is the basis for parts of the PIH notice, however the notice introduced a number of new concepts and methodologies to attribute income to NAHASDA in return for its assistance of former 1937 Act units. Since the publication of the notice, other informal guidance and legal opinions have rendered portions of the notice and regulation ambiguous and unenforceable. As a result, the policy fails to attribute any significant income to NAHASDA or even reimburse NAHASDA for the continued expense of operating 1937 Act units.

Comment 14 Indian Housing Authorities provided services to Native American tribes. To that end, there is no significant difference in meaning. We have changed the text to accommodate ONAP.

Comment 15 The transition requirements were not negotiated, however the statute's instructions for transition requirements are nonetheless part of Section 106 titled: "Regulations."

Comment 16 The Seattle Times article explained abuses of government funds. Creation of non-federal funds from redirected revenues extends the opportunity for abuse and alleviates ONAP oversight responsibilities by removing these funds from the scope of monitoring activities. However, our audit observed where ONAP reported similar abuses to those in the Seattle Times and knowingly accepted rent collected from NAHASDA subsidized housing as repayment. (See comment 10.)

Comment 17 NAHASDA provides tribes the opportunity to define affordable housing programs to achieve the goals of economic self-sufficiency and self-determination for tribes and their members. Self-determination does not imply full discretionary powers.

The scope of self-determination exists within many constraints, including the NAHASDA Act and regulations; other applicable acts and regulations such as those of the Office of Management and Budget, Environmental Protection Agency, Department of Labor, etc; Government Accountability Office standards; and other external requirements as specifically stated in the NAHASDA Act and regulations. NAHASDA's goal of self-determination is not an acceptable basis to defend the abuse of rent revenue from NAHASDA-assisted 1937 Act low-income housing.

Comment 18 ONAP disagreed with our findings and concluded that they are incorrect. For an explanation of how ONAP rendered the regulation and notice ambiguous, see comment 3. In comments 3, 4, and 8 we discuss how the guidance is inconsistent with generally accepted accounting principles. Finally, comment 5 explains that ONAP did not express their intention to redirect the revenue from NAHASDA-assisted 1937 Act units until after the review and comment period for the regulation and notice. The fund accounting procedures used to redirect the revenue are discussed in comment 4.

Comment 19 ONAP correctly asserts "that income from the operation of 1937 Act rental units is not program income (and therefore is not subject to any Federal requirement), unless the 1937 Act units are assisted with grant funds and the income is attributable to such assistance." However, ONAP's restatement of the regulation does not support their position for these reasons:

- The rent revenue they allow to be redirected is not "income" because expenses have not been deducted against "gross income" (revenue) as required in 24 CFR 1000.62(d).
- The units under question are assisted with NAHASDA grant funds, which mean their income cannot be automatically considered nonfederal funds.
- If the units are assisted with grant funds, any income, after deducting expenses, can be attributed to NAHASDA's assistance. Considering that NAHASDA has assisted these properties for over 10 years, the case could be made that all income is attributable to NAHASDA assistance.

Comment 20 ONAP is correct in stating that PIH Notice 2000-18 provides guidance on when income is attributable to NAHASDA assistance. In practice, however, the measures for when income is attributed to NAHASDA are often unattainable.

Section 3.4 of the notice states that all income from a 1937 Act unit is NAHASDA program income once cumulative NAHASDA funding for rehabilitation and capital expenditure meets or exceeds 40 percent of the maximum allowable dwelling construction and equipment cost, effective with the October 1, 1997 enactment of NAHASDA. However, ONAP has not defined what expenses constitute rehabilitation nor does ONAP require housing authorities to track rehabilitation on a per unit basis. As such, ONAP cannot identify when rehabilitation of a property exceeds 40 percent.

We found during resolution of our Warm Springs Housing Authority audit report, that ONAP does not believe it can enforce the rules associated with attributing assistance to NAHASDA, and does not require tribal housing authorities to keep records to do so. As a result, NAHASDA may have substantially rehabilitated a 1937 Act unit beyond 40 percent of its replacement cost, and no income would be attributed to NAHASDA. (See Audit Report No. 2008-SE-1001, dated Oct. 30 2007.) ONAP has shifted the burden of proof to the government by not enforcing an acceptable accounting system at the tribes.

Comment 21 ONAP officials have maintained this position even in examples where NAHASDA paid all costs of maintaining and operating a tribe's 1937 Act low-income housing and the resulting rent revenue was redirected and abused.

The ONAP policy failed to recoup the NAHASDA expenditures and/or attribute an acceptable amount of income for the NAHASDA assistance. As a result, the

ONAP policy classified the 1937 Act unit's rent revenue as non-federal and allowed those funds to be redirected to abuses and other activities that do not support affordable housing for Native Americans.

Comment 22 The sections we have quoted are relevant to the cancellation of the former 1937 Act grants and transition into assistance under NAHASDA. The act does not contain any language suggesting revenue from assisted properties should be abandoned as unrestricted non-federal funds. This was a policy decision, as discussed in comment 7.

Comment 23 The response to the second and third paragraph on page 6 is not consistent with ONAP's mission since the points referred to support assistance of affordable housing, not the redirection of funds away from affordable housing.

Comment 24 The first sentence on page 7 correctly restates the regulation by discussing when income is "attributed" to assistance.

Comment 25 As discussed in comment 5, there were no OIG objections to redirecting rent revenue from NAHASDA-assisted units during the Departmental clearance process because no such policy was expressed in either the regulation or the notice. The OIG did not have an opportunity to review this policy nor did we have this information at the time of negotiated rulemaking or review of the notice so that we could identify or quantify the potential abuse.

Comment 26 The chart on page 9 presents the substance of the transactions over the form. A housing authority's non-profit status has no effect on the fact ONAP allows them to treat NAHASDA-assisted 1937 Act housing as a profit center to provide funds for other activities that are also not normally associated with non-profits.

The chart is a measure of ONAP's controls over the operation of assisted housing. The chart reflects the maximum allowable profit from redirected funds and is not intended to represent any specific tribe's decision whether it redirects rent. Some tribes do not currently redirect the maximum amount, however many have changed their policy and ONAP has allowed tribes to retroactively recalculate and redirect past rent revenues.

Comment 27 Based on language in the notice and the decision not to offset revenues against expenses through matching, ONAP has created an implied entitlement to a new unrestricted income stream to the tribe. We did not observe any consideration exchanged for this income stream, other than the continued use of 1937 Act properties under NAHASDA. As discussed in comment 3, the rules under OMB Circular A-87 restrict payment for the use or depreciation of assets previously furnished by the government.

Guidance in PIH Notice 2000-18, section 3.4, stated that to attribute income to NAHASDA, the amount of rent collected before the enactment of NAHASDA

must be considered. A figure for each tribe was included as an appendix to the notice.

However, there was never any income under the 1937 Act program since funding was only provided as a subsidy for the authority's operating shortfall. Program income terminology was not used in the 1937 Act regulations and annual contributions contracts, since funding was provided as a subsidy for the authority's operating shortfall. Therefore, redirecting amounts equal to the authority's previous rent revenues is a new income stream that is passive in nature and is not earned as a result of any tribal investment in operations.

In practice, HUD allows tribes to first redirect rent, up to the pre-NAHASDA rent figures, before calculating income. However, redirecting any income, after offsetting expenses as described in this report, the regulation, and the notice, would not cause the abuse of current NAHASDA assistance.

Comment 28 ONAP did not have sufficient management controls in place to prevent this abuse or even prevent ONAP's participation in creating and defending the income stream used to support the abuse. Comment 6 addresses the legal opinion defending the policy.

Comment 29 The rent revenue is not subject to any Federal requirement based on a policy decision of ONAP and the informal guidance to circumvent the matching of revenue and expenses on NAHASDA-assisted 1937 Act units. See comment 21.

Comment 30 The policy to which the OIG objects originated from informal guidance that did not pass through the Departmental clearance process. It is not part of the regulation or the notice. No renegotiation is required, only the enforcement of 24 CFR 1000.62(d), clarification of the notice to properly use terms such as income and revenue, and creation of guidance that adheres to generally accepted accounting principles.

Comment 31 ONAP has misunderstood the dates provided in our Scope and Methodology section. We reviewed activities of Navajo Housing authority through 2006 during another review conducted during this audit's fieldwork, described as September 2006 to July 2008. During that fieldwork, we reviewed the Navajo monitoring report, dated September 7, 2005 and performed those steps deemed necessary to complete our scope of work. We concluded that it was not necessary to issue a separate report on the Navajo since the Southwest ONAP's scope and findings were sufficient to satisfy our audit objective.

Comment 32 Our review of the four tribes was not intended to be a statistical sample. It was intended to demonstrate the lack of controls present within ONAP. Based on our observations, we believe we have demonstrated that fact.

Comment 33 The process of negotiated rulemaking occurred within the constraints of the NAHASDA Act. There was no requirement in the Act or resulting negotiated regulation that requires the redirection of revenue away from assisted housing and to eventual abuses. Please refer to pages 11 through 15 of this report for examples of tribal leaders' actions that were inconsistent with the housing needs of low-income Native Americans.

Comment 34 We are not aware of any misstated requirements. We have presented our observations of the requirements here to assist in identifying the underlying causes of the abuse identified in this report. The legal opinions do not have a bearing on that determination as discussed in comment 6, but those opinions remain the official opinion of the Department.

Comment 35 As discussed in comment 8, accounting principles do not impose legal requirements on the use of revenue or NAHASDA funds. Rather, they standardize accounting practices used to calculate how much program income exists, in order to prevent redirecting those funds to abuse. Calculations based on the regulation and notice place restrictions on the future use of program income. The current disagreement over the calculation merely impacts how much of the rental revenues become program income.

Comment 36 The examples of violations and abuse in appendix H were funded from rent collected from tenants of NAHASDA-assisted 1937 Act housing. These rent collections could have been used for affordable housing, but were used with the knowledge and consent of ONAP officials to pay for violations and abuse identified in audit and monitoring findings. This is not intended to be a complete list and represents only those examples that were readily identifiable when we reviewed existing ONAP monitoring reports during our fieldwork.

Appendix B

ONAP MADE A MANAGEMENT DECISION TO NOT RESTRICT THE USE OF REVENUE FROM 1937 ACT PROPERTIES

OMB's Common Rule at 24 CFR 85.25(h) allowed HUD to determine future restrictions on revenues from former 1937 Act properties. As a result, HUD's policies released the restriction on most of the 1937 Act property rent revenues, even when operating expenses were paid entirely by the NAHASDA grants.

While HUD's Office of General Counsel argued that their implementation was within HUD's authority under NAHASDA, HUD could have taken more steps to protect affordable housing for low-income Native Americans. HUD's Office of General Counsel determined that it was a HUD policy decision, rather than a legal requirement that no restrictions were to apply to 1937 Act rent revenue after implementation of NAHASDA. HUD determined that upon implementation of NAHASDA, which included the termination of the 1937 Act grants and annual contributions contract provisions, 24 CFR 85.25(h) gave it the authority to determine the future use of "income" from assets constructed under the 1937 Act. HUD's choice was to not restrict use of these funds unless the units were assisted by NAHASDA and the income was attributed to that assistance.

When tribes elected not to receive NAHASDA assistance, there was no risk to the program. However, HUD took a position that while NAHASDA specified that former 1937 Act reserves, cash accounts, and the responsibility for maintaining and operating 1937 Act assets were transitioned into the new program, HUD could strip NAHASDA-assisted 1937 Act units of their future revenue stream and allow the tribes to use that revenue for other purposes without restrictions. The policy eliminated the property's self-sufficiency and drew significant resources from other NAHASDA activities.

Appendix C

HUD'S GUIDANCE ON PROGRAM INCOME DID NOT REQUIRE HOUSING AUTHORITIES TO MATCH REVENUES AND EXPENSES FROM NAHASDA-ASSISTED 1937 ACT UNITS

HUD's guidance on program income was inconsistent with NAHASDA and the regulations because it did not require housing authorities to match revenues and expenses from NAHASDA-assisted 1937 Act units. The program rules under 24 CFR 1000.62(d) specify that income is net of expenses. Based on our observations at several tribes, expenses often exceeded rent receipts, resulting in a net loss and the need for federal assistance.

However, ONAP guidance for calculating program income was vague, and ONAP interpreted the term "income" in a manner inconsistent with generally accepted accounting principles for housing authorities and the purpose and goals of NAHASDA. As a result, ONAP did not enforce the process of offsetting the revenue and expenses from NAHASDA-assisted 1937 Act units as required under program rules and generally accepted accounting principles' matching principle because it believed that rent from pre-NAHASDA units was owed to the tribes and could be redirected from operations before program income for those units was calculated.

ONAP's Guidance on Program Income Was Inconsistent with NAHASDA and the Regulations

ONAP's guidance on calculating program income for NAHASDA-assisted 1937 Act housing projects assumed that all revenue from 1937 Act units, as of implementation of NAHASDA, were the property of the tribes. For a NAHASDA-assisted 1937 Act unit, we believe that this assumption was inconsistent with the purpose and goals of NAHASDA. The guidance was also inconsistent with the regulations in its (1) differing treatment of receipts from Low Rent and Mutual Help program operations (gross versus net income used), (2) restrictions placed on sales proceeds from conveyance of Mutual Help program properties but not on the more significant long-term revenue stream from NAHASDA-assisted 1937 Act Low Rent program units, and (3) required provisions that were not included in the regulations.

The regulations at 24 CFR 1000.62 are ambiguous and resulted in additional guidance being developed by ONAP. That guidance provided a definition for income "attributable to" NAHASDA assistance. The definition, as implemented, was inconsistent with NAHASDA and regulations, generally accepted accounting principles for housing authority self-sufficiency, and OMB Circular A-87 requirements that establish standards for allowable costs such as reasonableness. The guidance did not require matching of revenues and expenses and obligated the government to unnecessarily fund operations and maintenance when rent revenues were already available. Our observations at several tribes demonstrated that none of the tribes successfully followed the guidance and only one attributed any significant revenues to NAHASDA assistance. Our attempts to recover wasted funds disclosed that ONAP guidance was unenforceable according to advice from the HUD Office of General Counsel.

Under a typical federal grant program, income produced by assisted assets is either consumed by the assisted program, restricted for specified purposes, or returned to the federal grant program or the government's interest is released at the end of the grant. In this example, the form of assistance changed from several programs under the 1937 Act into one grant program under NAHASDA. As part of the transition process, the 1937 Act grants were cancelled. However, rather than transitioning the government's interest in revenue from the former 1937 Act properties to the new program as they did with the responsibility for the assets, HUD officials agreed to release their interest in the revenues to the tribes even when the property required assistance.

Calculation of Income Did Not Follow Generally Accepted Accounting Principles

The term "income" in NAHASDA's program income guidance was undefined and inconsistently applied. The government's representatives on the program income subcommittee did not adequately consider the generally accepted accounting principles for proprietary funds and special governmental units such as housing authorities. The basis of the inconsistency is the requirement to match revenues and expenses of these 1937 Act units to calculate net income for program income accounting purposes. While proper matching would result in offsetting operating expenses against operating revenue, the staff attorney who participated in writing the guidance interpreted that the tribes could redirect rent revenue from the calculation of income before offsetting expenses. When this occurred, NAHASDA grant funds were necessary to pay the expenses of 1937 Act rentals.

The attorney's interpretation was based on construction of multiple funds to separate the calculation of net income between NAHASDA and the 1937 Act. However, this interpretation does not comply with the generally accepted accounting principles for housing authorities. According to OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, the term "generally accepted accounting principles" has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA). AICPA's Audit and Accounting Guide for Audits of State and Local Governmental Units states that if the criteria for proprietary funds are met, housing authorities should be reported as enterprise funds.

An enterprise fund is a proprietary fund for which the government decided one of the following:

a. The costs of providing goods and services are to be financed or recovered primarily through user charges.

b. The periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

While housing authorities met both conditions under the 1937 Act and NAHASDA, the first condition may not fully apply since there is no minimum rent set by NAHASDA. However, the second condition does apply since NAHASDA requires annual audits in conformance with OMB Circular A-133, Government Auditing Standards, and accounting based on generally accepted accounting principles.

Accounting principles for proprietary funds are generally those applicable to similar businesses in the private sector. The measurement focus is on the determination of net income, financial position, and cash flows. For purposes of calculating net income, all assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business are accounted for in a single proprietary fund, rather than a series of proprietary funds.

ONAP Program Guidance Memorandums 2001-3T and 2002-12 discussed a requirement for separating funds between the 1937 Act and NAHASDA operations for purposes of measuring and matching revenues and expenses. The guidance and a subsequent Office of General Counsel opinion, written by the same staff attorney, implied that revenue could only be matched to expenses that were paid with that revenue. This requirement did not reflect either generally accepted accounting principles for proprietary funds or commercial practices. Instead, generally accepted accounting principles require the accounting measurement to occur in one fund, with any split of the resulting income reflected in the restricted and unrestricted portions of the financial statements.

Appendix D

PURPOSE AND GOALS OF NAHASDA AND IMPLEMENTING REGULATIONS

The following criteria state the purpose and goals of NAHASDA and associated programs:

NAHASDA
(P.L. 104-330 as amended by P.L. 105-276, P.L. 106-568, P.L. 107-292, and P.L. 108-393)

"TITLE II--AFFORDABLE HOUSING ACTIVITIES
SEC. 201. NATIONAL OBJECTIVES AND ELIGIBLE FAMILIES.

(a) PRIMARY OBJECTIVE- The national objectives of this Act are--

(1) to assist and promote affordable housing activities to develop, maintain, and operate affordable housing in safe and healthy environments on Indian reservations and in other Indian areas for occupancy by low-income Indian families;

(2) to ensure better access to private mortgage markets for Indian tribes and their members and to promote self-sufficiency of Indian tribes and their members;

(3) to coordinate activities to provide housing for Indian tribes and their members with Federal, State, and local activities to further economic and community development for Indian tribes and their members;

(4) to plan for and integrate infrastructure resources for Indian tribes with housing development for tribes; and

(5) to promote the development of private capital markets in Indian country and to allow such markets to operate and grow, thereby benefiting Indian communities.

(b) ELIGIBLE FAMILIES-

(1) IN GENERAL- Except as provided under paragraphs (2) and (4), assistance under eligible housing activities under this Act shall be limited to low-income Indian families on Indian reservations and other Indian areas.

(2) EXCEPTION TO LOW-INCOME REQUIREMENT- A recipient may provide assistance for homeownership activities under section 202(2), model activities under section 202(6), or loan guarantee activities under title VI to Indian families who are not low-income families, to the extent that the Secretary approves the activities pursuant to such section or title because there is a need for housing for such families that cannot reasonably be met without such assistance. The Secretary shall establish limits on the amount of assistance that may be provided under this Act for activities for families who are not low-income families.

(3) NON-INDIAN FAMILIES- Notwithstanding paragraph (1), a recipient may provide housing or housing assistance provided through affordable housing activities assisted with grant amounts under this Act for a non-Indian family on an Indian reservation or other Indian area if the recipient determines that the presence of the family on the Indian reservation or other Indian area is essential to the well-being of Indian families and the need for housing for the family cannot reasonably be met without such assistance.

(4) LAW ENFORCEMENT OFFICERS- A recipient may provide housing or housing assistance provided through affordable housing activities assisted with grant amounts under this Act for a law enforcement officer on an Indian reservation or other Indian area, if--

(A) the officer—

(i) is employed on a full-time basis by the Federal Government or a State, county, or lawfully recognized tribal government; and

(ii) in implementing such full-time employment, is sworn to uphold, and make arrests for, violations of Federal, State, county, or tribal law; and

(B) the recipient determines that the presence of the law enforcement officer on the Indian reservation or other Indian area may deter crime.

(5) PREFERENCE FOR TRIBAL MEMBERS AND OTHER INDIAN FAMILIES- The Indian housing plan for an Indian tribe may require preference, for housing or housing assistance provided through affordable housing activities assisted with grant amounts provided under this Act on behalf of such tribe, to be given (to the extent practicable) to Indian families who are members of such tribe, or to other Indian families. In any case in which the applicable Indian housing plan for an Indian tribe provides for preference under this paragraph, the recipient for the tribe shall ensure that housing activities that are assisted with grant amounts under this Act for such tribe are subject to such preference.

(6) EXEMPTION- Title VI of the Civil Rights Act of 1964 and title VIII of the Civil Rights Act of 1968 shall not apply to actions by federally recognized tribes and the tribally designated housing entities of those tribes under this Act."

"SEC. 202. ELIGIBLE AFFORDABLE HOUSING ACTIVITIES.

Affordable housing activities under this title are activities, in accordance with the requirements of this title, to develop or to support affordable housing for rental or homeownership, or to provide housing services with respect to affordable housing, through the following activities:

(1) INDIAN HOUSING ASSISTANCE- The provision of modernization or operating assistance for housing previously developed or operated pursuant to a contract between the Secretary and an Indian housing authority.

(2) DEVELOPMENT- The acquisition, new construction, reconstruction, or moderate or substantial rehabilitation of affordable housing, which may include real property acquisition, site improvement, development of utilities and utility services, conversion, demolition, financing, administration and planning, improvement to achieve greater energy efficiency, and other related activities.

(3) HOUSING SERVICES- The provision of housing-related services for affordable housing, such as housing counseling in connection with rental or homeownership assistance, establishment and support of resident organizations and resident management corporations, energy auditing, activities related to the provision of self-sufficiency and other services, and other services related to assisting owners, tenants, contractors, and other entities, participating or seeking to participate in other housing activities assisted pursuant to this section.

(4) HOUSING MANAGEMENT SERVICES- The provision of management services for affordable housing, including preparation of work specifications, loan processing, inspections, tenant selection, management of tenant-based rental assistance, and management of affordable housing projects.

(5) CRIME PREVENTION AND SAFETY ACTIVITIES- The provision of safety, security, and law enforcement measures and activities appropriate to protect residents of affordable housing from crime.

(6) MODEL ACTIVITIES- Housing activities under model programs that are designed to carry out the purposes of this Act and are specifically approved by the Secretary as appropriate for such purpose.

(7) COMMUNITY DEVELOPMENT DEMONSTRATION PROJECT.—

(A) IN GENERAL.—Consistent with principles of Indian self-determination and the findings of this Act, the Secretary shall conduct and submit to Congress a study of the feasibility of establishing a demonstration project in which Indian tribes, tribal organizations, or tribal consortia are authorized to expend amounts received pursuant to the Native American Housing Assistance and Self-Determination Reauthorization Act of 2002 in order to design, implement, and operate community development demonstration projects.

(B) STUDY.—Not later than 1 year after the date of enactment of the Native American Housing Assistance and Self-Determination Reauthorization Act of 2002, the Secretary shall submit the study conducted under subparagraph (A) to the Committee on Banking, Housing, and Urban Affairs and the Committee on Indian Affairs of the Senate, and the Committee on Financial Services and the Committee on Resources of the House of Representatives.

(8) SELF-DETERMINATION ACT DEMONSTRATION PROJECT.

(A) IN GENERAL.—Consistent with the provisions of the Indian Self-Determination and Education Assistance Act (25 U.S.C. 450 et seq.), the Secretary shall conduct and submit to Congress a study of the feasibility of establishing a demonstration project in which Indian tribes and tribal organizations are authorized to receive assistance in a manner that maximizes tribal authority and decision-making in the design and implementation of Federal housing and related activity funding.

(B) STUDY.—Not later than 1 year after the date of enactment of the Native American Housing Assistance and Self-Determination Reauthorization Act of 2002, the Secretary shall submit the study conducted under subparagraph (A) to the Committee on Banking, Housing, and Urban Affairs and the Committee on Indian Affairs of the Senate, and the Committee on Financial Services and the Committee on Resources of the House of Representatives."

NAHASDA Regulations at 24 CFR 1000

(as published on pages 12351 and 12352 of the *Federal Register*/Vol. 63, No. 48/Thursday, March 12, 1998/Rules and Regulations)

"§ 1000.1 What is the applicability and scope of these regulations?
Under the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4101 et seq.) (NAHASDA) the Department of Housing and Urban Development (HUD) provides grants, loan guarantees, and technical assistance to Indian tribes and Alaska Native villages for the development and operation of low income housing in Indian areas. The policies and procedures described in this part apply to grants to eligible recipients under the Indian Housing Block Grant (IHBG) program for Indian tribes and Alaska Native villages. This part also applies to loan guarantee assistance under title VI of NAHASDA. The regulations in this part supplement the statutory requirements set forth in NAHASDA. This part, as much as practicable, does not repeat statutory language."

"§ 1000.2 What are the guiding principles in the implementation of NAHASDA?
(a) The Secretary shall use the following Congressional findings set forth in section 2 of NAHASDA as the guiding principles in the implementation of NAHASDA:

(1) The Federal government has a responsibility to promote the general welfare of the Nation:

(i) By using Federal resources to aid families and individuals seeking affordable homes in safe and healthy environments and, in particular, assisting responsible, deserving citizens who cannot provide fully for themselves because of temporary circumstances or factors beyond their control;

(ii) By working to ensure a thriving national economy and a strong private housing market; and

(iii) By developing effective partnerships among the Federal government, state, tribal, and local governments, and private entities that allow government to accept responsibility for fostering the development of a healthy marketplace and allow families to prosper without government involvement in their day-to-day activities.

(2) There exists a unique relationship between the Government of the United States and the governments of Indian tribes and a unique Federal responsibility to Indian people.

(3) The Constitution of the United States invests the Congress with plenary power over the field of Indian affairs, and through treaties, statutes, and historical relations with Indian tribes, the United States has undertaken a unique trust responsibility to protect and support Indian tribes and Indian people.

(4) The Congress, through treaties, statutes, and the general course of dealing with Indian tribes, has assumed a trust responsibility for the protection and preservation of Indian tribes and for working with Indian tribes and their members to improve their housing conditions and socioeconomic status so that they are able to take greater responsibility for their own economic condition.

(5) Providing affordable homes in safe and healthy environments is an essential element in the special role of the United States in helping Indian tribes and their members to improve their housing conditions and socioeconomic status.

(6) The need for affordable homes in safe and healthy environments on Indian reservations, in Indian communities, and in Native Alaskan villages is acute and the Federal government should work not only to provide housing assistance, but also, to the extent practicable, to assist in the development of private housing finance mechanisms on Indian lands to achieve the goals of economic self-sufficiency and self-determination for Indian tribes and their members.

(7) Federal assistance to meet these responsibilities should be provided in a manner that recognizes the right of Indian self-determination and tribal self governance by making such assistance available directly to the Indian tribes or tribally designated entities under authorities similar to those accorded Indian tribes in Public Law 93–638 (25 U.S.C. 450 et seq.)

(b) Nothing in this section shall be construed as releasing the United States government from any responsibility arising under its trust responsibilities towards Indians or any treaty or treaties with an Indian tribe or nation."

"§ 1000.4 What are the objectives of NAHASDA?

The primary objectives of NAHASDA are:

(a) To assist and promote affordable housing activities to develop, maintain and operate affordable housing in safe and healthy environments on Indian reservations and in other Indian areas for occupancy by low-income Indian families;

(b) To ensure better access to private mortgage markets for Indian tribes and their members and to promote self sufficiency of Indian tribes and their members;

(c) To coordinate activities to provide housing for Indian tribes and their members and to promote self sufficiency of Indian tribes and their members;

(d) To plan for and integrate infrastructure resources for Indian tribes with housing development for Indian tribes; and

(e) To promote the development of private capital markets in Indian country and to allow such markets to operate and grow, thereby benefiting Indian communities."

"§ 1000.6 What is the nature of the IHBG program?
The IHBG program is formula driven whereby eligible recipients of funding receive an equitable share of appropriations made by the Congress, based upon formula components specified under subpart D of this part. IHBG recipients must have the administrative capacity to undertake the affordable housing activities proposed, including the systems of internal control necessary to administer these activities effectively without fraud, waste, or mismanagement."

Appendix E

REGULATIONS AND GUIDANCE FOR PROGRAM INCOME

The following regulations and guidance relate to program income accounting for NAHASDA-assisted 1937 Act units.

NAHASDA Regulations at 24 CFR 1000
(as published on pages 12359 and 12360 of the *Federal Register*/Vol. 63, No. 48/Thursday, March 12, 1998/Rules and Regulations)

"§ 1000.62 What is considered program income and what restrictions are there on its use?

(a) Program income is defined as any income that is realized from the disbursement of grant amounts. Program income does not include any amounts generated from the operation of 1937 Act units unless the units are assisted with grant amounts and the income is attributable to such assistance. Program income includes income from fees for services performed from the use of real or rental of real or personal property acquired with grant funds, from the sale of commodities or items developed, acquired, etc. with grant funds, and from payments of principal and interest earned on grant funds prior to disbursement.

(b) Any program income can be retained by a recipient provided it is used for affordable housing activities in accordance with section 202 of NAHASDA. If the amount of income received in a single year by a recipient and all its subrecipients, which would otherwise be considered program income, does not exceed $25,000, such funds may be retained but will not be considered to be or treated as program income.

(c) If program income is realized from an eligible activity funded with both grant funds as well as other funds (i.e., funds that are not grant funds), then the amount of program income realized will be based on a percentage calculation that represents the proportional share of funds provided for the activity generating the program income.

(d) Costs incident to the generation of program income shall be deducted from gross income to determine program income."

PIH Notice 2000-18
(Dated, May 30, 2000)

"3.4. Income generated from the operation of 1937 Housing Act units assisted with IHBG grants.

IHBG funds may be used for the operation and maintenance and the rehabilitation of 1937 Housing Act units. When 1937 Housing Act units are assisted with IHBG funds, the

income from the units is program income if it is attributable to the IHBG assistance. To determine how much of the income is program income when the IHBG funds are used for operation and maintenance of rental units, the amount of income received from such units before the date of the enactment of NAHASDA (10/01/1997) must be considered.

Instead of having to determine and track the actual amount of rent received for each 1937 Housing Act rental unit as of the date of the enactment of NAHASDA, a surrogate will be used. This surrogate is 46% of the Allowable Expense Level (AEL) for the recipient. This number reflects the national average for rents received for 1937 Housing Act units in the last year of the 1937 Housing Act programs for Indians. The AEL and 46% of the AEL for each Indian tribe with 1937 Housing Act units are set forth in the Appendix. The AEL is defined in §1000.302. Program income is the amount of total income for a project identified as Formula Current Assisted Stock (FCAS) on the tribe's Formula Response Form that exceeds 46% of the per unit AEL times the number of units in the project. The calculation may be done monthly or annually."

Appendix F

CRITERIA FOR MANAGEMENT CONTROLS

The following requirements relate to the responsibilities of managers for assessing the risks faced by agency programs:

OMB Circular A-123, Management Accountability and Control, Revised June 21, 1995

I. INTRODUCTION

"The proper stewardship of Federal resources is a fundamental responsibility of agency managers and staff. Federal employees must ensure that government resources are used efficiently and effectively to achieve intended program results. Resources must be used consistent with agency mission, in compliance with law and regulation, and with minimal potential for waste, fraud, and mismanagement."

II. ESTABLISHING MANAGEMENT CONTROLS

"Standards. Agency managers shall incorporate basic management controls in the strategies, plans, guidance and procedures that govern their programs and operations. Controls shall be consistent with the following standards, which are drawn in large part from the "Standards for Internal Control in the Federal Government," issued by the General Accounting Office (GAO).

General management control standards are:

- Compliance with Law. All program operations, obligations and costs must comply with applicable law and regulation. Resources should be efficiently and effectively allocated for duly authorized purposes.

- Reasonable Assurance and Safeguards. Management controls must provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. Management controls developed for agency programs should be logical, applicable, reasonably complete, and effective and efficient in accomplishing management objectives.

- Integrity, Competence, and Attitude. Managers and employees must have personal integrity and are obligated to support the ethics programs in their agencies. The spirit of the Standards of Ethical Conduct requires that they develop and implement effective management controls and maintain a level of competence that allows them to accomplish their assigned duties. Effective communication within and between offices should be encouraged."

HUD Handbook 1840.1, Chapter 1-3, Departmental Management Control Program

A. "Management controls are policies and procedures adopted by managers to ensure that program objectives are efficiently and effectively accomplished within planned timeframes, within budgetary limitations and with the intended quality and quantity of output. ..."

B. "The Management Control Program includes a risk assessment. Primary Organization Heads (POHs) and their managers must review the activities or group of activities in the functional areas to determine susceptibility to losses which would result if effective management controls are not in place. Also, front-end risk assessments (FERAs) are to be performed for new or significantly revised programs or administrative functions (see Chapter 8)."

D. "Implementation of the Management Control Program requires involvement by managers and supervisors at all levels. All managers and supervisors are responsible for ensuring that adequate management controls exist so that activities under their control are conducted in an effective and efficient manner. Major roles and responsibilities are as follows:"

4. "POHs are responsible for program implementation in their respective functional areas. This includes the designation of Management Control Coordinators (MCCs), evaluation of management controls, implementation of corrective actions, reporting, quality control, and assuring that accountability for management controls is built into all performance evaluation systems (EPPES/EPAS)."

Appendix G

GOVERNMENT AUDITING STANDARDS FOR REPORTING ABUSE

The following requirements relate to the auditor's responsibility for reporting abuse observed during performance audits under GAO's Government Auditing Standards (GAO-07-731G), July 2007 Revision:

Abuse

"**7.33** Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement.

7.34 If during the course of the audit, auditors become aware of abuse that could be quantitatively or qualitatively significant to the program under audit, auditors should apply audit procedures specifically directed to ascertain the potential effect on the program under audit within the context of the audit objectives. After performing additional work, auditors may discover that the abuse represents potential fraud or illegal acts. Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse."

Reporting

8.21 "When auditors conclude, based on sufficient, appropriate evidence, that fraud, illegal acts, significant violations of provisions of contracts or grant agreements, or significant abuse either has occurred or is likely to have occurred, they should report the matter as a finding."

Appendix H

SCHEDULE OF RENT REVENUE REDIRECTED FROM 1937 ACT PROPERTIES

Our audit included reviewing policies and practices at four tribes and ONAP monitoring reports. Our observations identified over $12.6 million in revenue redirected from low-income housing programs under NAHASDA. The total amount of revenue actually redirected from 1937 Act properties is not known.

Report Date	Tribal Housing Entity	Amount	Description
10/30/2007	Warm Springs Housing Authority	$119,861	Unsupported compensation of housing officials
10/30/2007	Warm Springs Housing Authority	$204,456	Unsupported travel expenses questioned during a 2003 ONAP monitoring review
10/30/2007	Warm Springs Housing Authority	$121,390	Unallowable tenant bad debt written off
10/30/2007	Warm Springs Housing Authority	$18,495	HUD-rejected expenses
10/30/2007	Warm Springs Housing Authority	$6,964	Questioned travel from a Warm Springs internal audit
10/30/2007	Warm Springs Housing Authority	$11,176	Unreimbursed personal expenses of former Authority board members and key employees on Authority credit cards
9/7/2005	Navajo Housing Authority	$765,435	Lobbying expenditures during the period January 2004 through June 2007
9/7/2005	Navajo Housing Authority	$1,900,000	The Cabinets Southwest project (Cabinet plant)
9/7/2005	Navajo Housing Authority	$4,189,196	The Chaco Trails project (Mixed Income Development)
9/7/2005	Navajo Housing Authority	$3,786,453	The Flexcrete Building System project
		$11,123,426	Amounts reported on Page 12

Report Date	Tribal Housing Entity	Amount	Description
12/15/2005	Lower Elwha Housing Authority	$2,971	Ineligible expenditures
1/6/2003	Tulalip Housing Authority	$425,256	Unallowable expenditures reimbursed
8/19/2005	Puyallup Tribe	$42,613	Families who were not eligible to receive NAHASDA funds
8/2/2002	Quileute Housing Authority	$365,439	Construction of a day care center
8/22/2003	Pueblo of Jemez	$54,768	Ineligible expenditures
8/1/2005	Te-Moak Tribe	$120,690	Ineligible costs for monthly payments to the board chairperson, attorney fees associated with the Tribe's gaming operation, ineligible travel expenses and other miscellaneous expenses
8/2/2000	Turtle Mountain Housing Authority	$179,607	Development expenses performed without an environmental review
8/2/2000	Turtle Mountain Housing Authority	$114,562	Undocumented expenses
5/27/2004	White Mountain Apache Housing Authority	$7,735	Ineligible costs
5/27/2004	White Mountain Apache Housing Authority	$3,442	Inelegible payments to two individuals
5/27/2004	White Mountain Apache Housing Authority	$32,847	The cost of an election dispute
10/29/2003	Pueblo of Laguna	$93,035	Ineligible grant costs
		$1,442,965	Amounts reported on Page 13
		$12,566,391	