audit report

Issue Date April 28, 2008	
Audit Report Number 2008-SE-1003	

TO: Randall R. Akers, ONAP Administrator, Northern Plains Office of Native American Programs, 8API

Joan S. Hobbs

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

SUBJECT: Salish and Kootenai Housing Authority, Pablo, Montana, Did Not Properly Recognize and Account for Program Income from 1937 Act Housing Projects

HIGHLIGHTS

What We Audited and Why

We audited Salish and Kootenai Housing Authority (Authority) as part of our review of the Office of Native American Programs' guidance on calculating program income for United States Housing Act of 1937 (1937 Act) housing projects assisted by the Native American Housing Assistance and Self Determination Act of 1996 (NAHASDA). The objective of the audit was to determine whether the Authority calculated program income for NAHASDA-assisted 1937 Act properties in accordance with applicable U.S. Department of Housing and Urban Development (HUD) guidance, regulations, and requirements and to observe uses of revenue from NAHASDA-assisted 1937 Act properties.

What We Found

The Authority did not have adequate accounting policies and procedures for allocating income from 1937 Act properties receiving Indian Housing Block Grant (Block Grant) program assistance between its general fund and Block Grant programs. It failed to track Block Grant rehabilitation or capital expenses for each property and recognize NAHASDA revenue from substantially rehabilitated properties. It also miscalculated the amount of program income because it included units converted to non-NAHASDA tax credit units in its average expense level calculation. As a result, more than $184,000 in low-rent housing receipts were inappropriately excluded from Block Grant affordable housing funds during the period October 1, 2002, through December 31, 2006, and should be reclassified. These conditions occurred because management created policies and procedures for determining and administering program income that did not comply with applicable guidance and regulations.

What We Recommend

We recommend that HUD require the Authority to (1) implement policies and procedures to determine program income in accordance with HUD requirements; (2) update its computation of program income, properly segregating the revenue and allowable expense level calculation for low-income housing tax credit properties from other 1937 Act low-rent units and reclassifying $174,054, previously withdrawn from the 1937 Act low-rent program as nonprogram income, as Block Grant funds; (3) reduce the number of 1937 Act units capable of producing nonprogram income by the nine units that received substantial rehabilitation or capital expenses between 2002 and 2006 using Block Grant funds, which exceeded 40 percent of the dwelling, construction, and equipment costs, and reclassify $10,172 as NAHASDA revenue; and (4) adjust the annual 2007 and forward 1937 Act program income calculations to include all revenue from substantially rehabilitated units as NAHASDA revenue.

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 our discussion draft to the Authority and HUD's Northern Plains Office of Native American Programs on March 11, 2008, and held an exit conference on March 18, 2008. The Authority disagreed with our finding and recommendation to track capital expenditures as instructed in HUD program income guidance and as defined in OMB Circular A-87. Instead, the Authority developed their own definition of long-term maintenance and rehabilitation which avoids attributing income to NAHASDA's assistance of 1937 Act units.

Also, the Authority agreed with the finding that they needed to correct the unit count used to calculate program income, but disagreed on the recommended correction. The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The Salish and Kootenai Housing Authority (Authority) is the tribally designated housing entity for the Confederated Salish and Kootenai Tribes. It is located on the Flathead Indian Reservation in Western Montana. The Authority was organized to provide housing for qualified individuals. It is governed by a board of up to seven commissioners who are appointed by the tribal council. Consequently, the Authority is considered a component unit of the tribe.

The Authority is a reservation-wide agency responsible for planning, coordinating, and delivering services, which support the purpose of the agency. It was organized and is operated to act as a recipient of Native American Housing Assistance and Self Determination Act of 1996 (NAHASDA) Indian Housing Block Grant (Block Grant) funds, administer such funds in accordance with NAHASDA; remedy unsafe and unsanitary housing conditions; provide employment opportunities; improve the quality of life in all reservation communities; engage in housing-related activities and services; and participate in other entities formed to accomplish any of these purposes including acting as a general partner in limited partnerships.

The Authority developed, maintained, and operated low-rent and mutual help units assisted under the United States Housing Act of 1937 (1937 Act), as amended. On October 1, 1997, NAHASDA reorganized the system of housing assistance provided to Native Americans by the U.S. Department of Housing and Urban Development (HUD), eliminating several separate programs of assistance, and replaced them with a NAHASDA Block Grant program. For those units previously assisted under the 1937 Act, the Block Grant program provided for continued operating and maintenance assistance.

The Authority used Block Grant program funds to operate and maintain low-rent units and rehabilitate mutual help units that were previously assisted under the 1937 Act. In fiscal year 2007, the Authority had 414 low-rent and 82 mutual help units. The regulations at 24 CFR [*Code of Federal Regulations*] 1000.62(a) govern how rents collected from low-rent units and proceeds of sale from mutual help units are allocated between the Block Grant program income and the Authority as nonprogram income. The regulation states that Block Grant 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. Public and Indian Housing (PIH) Notice 2000-18 provides guidance on accounting for program income generated by the use or disbursement of Block Grant funds.

Our objective was to determine whether the Authority calculated program income for Block Grant-assisted 1937 Act properties in accordance with applicable HUD guidance, regulations, and requirements and to observe uses of revenue from Block Grant-assisted 1937 Act properties.

RESULTS OF AUDIT

Finding 1: The Authority Could Not Properly Account for Block Grant Program Income

The Authority did not allocate income from NAHASDA-assisted 1937 Act properties between its general fund and NAHASDA Block Grant programs in accordance with HUD requirements. Although the Authority's records were sufficient to support a proper allocation, its accounting systems failed to track NAHASDA's cumulative investment in individual 1937 Act single-family housing units. Additionally, the Authority overcalculated its nonprogram income by including an allowable expense level (AEL) amount for 33 1937 Act units that were transferred to a non-NAHASDA tax credit partnership. This condition occurred because (1) the Authority's policies did not follow Office of Management and Budget (OMB) Circular A-87 cost principles and classified Block Grant expenditures for rehabilitation and capitol improvements as maintenance expenses, and (2) the Authority's accounting controls did not ensure that the correct number of NAHASDA-assisted units was used in its program income calculation. As a result, the Authority understated NAHASDA revenue by more than $184,000 from 1937 Act low-rent housing receipts.

HUD Requirements

The regulations at 24 CFR 1000.62(a) state that 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. For low-rent units receiving Block Grant program assistance, PIH Notice 2000-18 provides that the tribally designated housing entity may retain as nonprogram income the lesser of total income or 46 percent of the AEL for the recipient times the number of units. For mutual help units receiving Block Grant program assistance, the notice provides that the tribally designated housing entity may retain the proceeds of the sale of units as nonprogram income. However, HUD restricts the use of nonprogram income from mutual help unit sales to housing activities, community facilities, or economic development activities that benefit the community.

Section 3.4 of the notice also states that all income from a 1937 Act low-rent or mutual help 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 (DC&E), effective with the October 1, 1997, enactment of NAHASDA. According to the notice, the 40 percent threshold is only a concept for accounting for program income and has no effect in determining what is considered eligible formula current assisted stock under the Block Grant formula.

On July 9, 2002, HUD issued guidance to remind grant recipients of the program income requirements pertaining to 1937 Act units supported with Block Grant funds. The guidance noted that in the absence of an accounting system meeting the requirements of PIH Notice 2000-18 to allocate income attributable to the 1937 Act and Block Grant programs, all income would be program income and would be required to be used for Block Grant program purposes. PIH Notice 2000-18 also requires that the accounting system track the total income by project and the total Block Grant-funded rehabilitation by unit.

NAHASDA-Funded Rehabilitation Expenses Not Properly Tracked

The Authority did not track NAHASDA's cumulative investment in individual 1937 Act single-family housing units as required by PIH Notice 2000-18, section 3.4. The Authority's accounting processes failed to reclassify 1937 Act units as NAHASDA units when these units received NAHASDA-funded rehabilitation or capital improvements. When this cumulative investment reaches the 40 percent of DC&E figure discussed above, the unit is considered substantially rehabilitated by NAHASDA and becomes a NAHASDA unit for program income purposes.

The Authority's policy required the capitalization of repairs in excess of $5,000. In addition, the Authority chose to incur rehabilitation costs using NAHASDA funds. If rehabilitation was required, the Authority's plan was to use other funds such as low-income housing tax credits to fund the rehabilitation. In implementing its maintenance policy, the Authority recorded no rehabilitation or modernization on its units and, therefore, did not track the assistance provided for each unit. Modernization or rehabilitation was only separated from other maintenance when "many rental units have inadequate or out of date equipment or require common repair, rehabilitation, or refurbishment and when operating funds are insufficient to meet anticipated costs."

However, the Authority's definition of rehabilitation includes many activities that constitute capital expenditures and is not consistent with the definition of maintenance in OMB Circular A-87 cost principles (2 CFR 225), appendix B, paragraph 25, which states:

> Maintenance, operations, and repairs. Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: keep property (including Federal property, unless otherwise provided for) in an efficient operating condition, do not add to the permanent value of property or appreciably prolong its intended life, and are not otherwise included in rental or other charges for space. Costs which add to the permanent value of property or appreciably prolong its intended life shall be treated as capital expenditures.

Significant Block Grant-Funded Capital Expenditures Observed

We reviewed the Authority's NAHASDA-funded maintenance expenditures for 1937 Act units and observed numerous examples of expenditures between 2002 and 2007 that should have been classified as capital expenditures in conformance with OMB Circular A-87 requirements. We also noted expenditures exceeding the Authority's $5,000 capitalization threshold, which were not capitalized in the Authority's accounting records. We observed 26 units with capital expenditures exceeding $20,000 from 2002 to 2007.

Nine of the 26 units exceeded the 40 percent of DC&E threshold based on our review and reclassification of capital expenditures as follows.

Units substantially rehabilitated with NAHASDA funds						
Date of transition	Unit	Months since transition, as of Dec. 2006	NAHASDA funds net of credits *	Beds	40 % of DC&E	Exceeds DC&E by:
Aug. 31, 2004	1502	28	45,020	3	24,845	20,175
Dec. 31, 2005	2612	12	45,650	3	24,845	20,805
Jan. 3, 2006	1833	12	41,990	4	29,753	12,237
Mar. 22, 2006	2808	10	29,790	3	24,845	4,945
June 27, 2003	3104	43	26,715	2	22,690	4,025
Aug. 22, 2007	3028	0	23,290	2	22,690	600
May 31, 2007	3126	0	29,995	3	24,845	5,150
Apr. 10, 2007	349	0	31,538	2	22,690	8,848
May 18, 2007	702	0	32,894	3	24,845	8,049
	Total months:	105				

* Credits include reimbursements from residents and homeowner equity.

<u>Mutual Help</u>
Two mutual help units converted to low rent after substantial rehabilitation occurred and will now produce NAHASDA revenue. Unit 1502, converted to unit 348 on August 31, 2004, and unit 2612 converted to unit 2824 on December 31, 2005. Neither unit produced proceeds of sale.

<u>Low Rent</u>
Each month that a low-rent unit was not transitioned to NAHASDA, the Authority was eligible to convert $97 to nonprogram income. The seven low-rent units, along with the two converted mutual help units, will now produce $873 in NAHASDA revenue per month or $10,476 per year, based on PIH Notice 2000-18, section 3.4, which limits

nonprogram income per unit to 46 percent of the AEL. The AEL figure is $211 per month for the Authority, as listed in the appendix to PIH Notice 2000-18.

We also noted that four additional units were within $1,200 of exceeding the threshold. Since the nine units above exceeded the 40 percent threshold, they should have been transitioned as NAHASDA units, with all income from these units recognized as NAHASDA revenue. The Authority's failure to track the capital expenditures for the nine units shown above allowed it to classify $10,172 (105 months times $97) in income from these units as nonprogram income from the time that the 40 percent threshold was met through December 2006. This amount should be reclassified as NAHASDA revenue, and a similar adjustment will be required for future program income computations.

Calculation of Nonprogram Income

From October 2002 through December 2006, the Authority collected more than $2.1 million in gross income from its 381 NAHASDA-subsidized 1937 Act low-rent units. However, the AEL calculation for allocating program and nonprogram income was based on 414 low-rent units because the Authority did not remove 33 units that were transferred into a low-income tax credit project in June 2002. These 33 units were not subsidized with NAHASDA funds during this period.

Using the inflated AEL, the Authority recognized only $69,078 in program income over the period for these units. Had the Authority used the proper unit count for the AEL, the annual AEL amount would have decreased from $482,194 to $443,758, and the Authority would have reported an additional $174,054 in NAHASDA program income earned by the low-rent program.

Program income calculations

Program year end	Sept. 30, 2003	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2006	Totals
Total rent revenue (from 381 units)	$488,009	$636,214	$517,801	$487,081	**$2,129,105**
Less: 46% of total AEL					
414 units	(482,194)	(602,743)	(482,194)	(482,194)	
381 units	(443,758)	(554,698)	(443,758)	(443,758)	
Net program income					
414 units	5,815	33,471	35,607	4,887	
381 units	44,251	81,516	74,043	43,323	
Program income					
414 units	None	$33,471	$35,607	None	**69,078**
381 units	$44,251	$81,516	$74,043	$43,323	**243,132**
Underreported NAHASDA revenue					**$174,054**
Note: If program income is less than $25,000, no program income is recognized.					

Use of Nonprogram Income

We observed that the primary use of nonprogram income from NAHASDA-assisted 1937 Act units was to fund low-income housing tax credit properties. This nonprogram income was commingled in a general fund with revenue from other Authority operations. The Authority did not track how it spent the nonprogram income from its 1937 Act rental units. However, during the period 2004 through 2006, it spent more on housing-related activities than the amount of nonprogram income obtained from the NAHASDA-assisted 1937 Act rental units. Therefore, we determined that there was little risk of abuse of nonprogram income.

Conclusion

Since the Authority did not have a compliant definition of maintenance in place and disregarded capital expenditures, it did not track actual dwelling construction and equipment costs for its 1937 Act units at the unit level. As a result, it did not ensure the accuracy of its program income calculation for its 1937 Act units assisted with Block Grant funds by recognizing NAHASDA revenue from assets substantially rehabilitated using NAHASDA funds. In addition, the calculation contained an inflated AEL that reduced the amount of program income attributed to NAHASDA.

Recommendations

We recommend that HUD require the Authority to

1A. Implement policies and procedures to determine program income in accordance with HUD requirements, to include a corrected definition of maintenance and the Authority’s ability to track Block Grant-funded rehabilitation and/or capital expenses by 1937 Act unit from both contracts and internal work orders.

1B. Update its computation of program income, properly segregating the revenue and AEL calculation for low-income housing tax credit properties from other 1937 Act low-rent units and reclassifying $174,054, which was previously withdrawn from the 1937 Act low-rent program as nonprogram income, as Block Grant funds.

1C. Reduce the number of 1937 Act units capable of producing nonprogram income by the nine units that received substantial rehabilitation or capital expenses between 2002 and 2006 using Block Grant funds, which exceeded 40 percent of the dwelling, construction, and equipment costs, and reclassify $10,172 as NAHASDA revenue.

1D. Adjust the annual 2007 and forward program income calculations to include revenue from all substantially rehabilitated units as NAHASDA revenue.

SCOPE AND METHODOLOGY

Our objective was to determine whether the tribe complied with criteria for program income from Block Grant-assisted 1937 Act housing projects and to observe uses of revenue from Block Grant-assisted 1937 Act properties. The criteria are contained in NAHASDA implementing regulations found in 24 CFR 1000.62, HUD's Office of Native American Programs' guidance, and external requirements such as those from the General Accounting Office and the Office of Management and Budget. The audit steps were designed to gain an understanding of the 1937 Act income and related use restrictions, the accounting for associated program income, and support used to calculate program and nonprogram income.

To accomplish our objectives, we reviewed the Authority's calculation of program income from Block Grant-assisted 1937 Act housing projects and related supporting data at its offices in Pablo, Montana. We reviewed sufficient cost accounting system information to confirm whether the accounting system was capable of tracking rehabilitation and/or capital expenditures at the housing unit level, as required to remove nonprogram income. We also reviewed the system for tracking the transition of unit income from a 1937 Act identity to a Block Grant identity. Finally, we observed the use of nonprogram income generated from Block Grant-assisted 1937 Act units. Our observations included review of the Authority's fiscal years 1999 through 2004 financial audits.

We reviewed the Authority's accounting system for reports that might identify any units that exceeded the 40 percent dwelling construction and equipment cost limit for the program income calculation. Its new electronic system could only report back to its implementation in 2006 and could not provide sufficient data to satisfy this tracking requirement. To further support these conclusions, we reviewed records of maintenance and rehabilitation work performed at tenant move-out and at the time of casualty damages.

We randomly selected a sample of 12 of the Authority's 496 1937 Act units between Polson and Dixon, Montana. These units included six low-rent units, three nonconveyed mutual help units, and three low-rent units that had rehabilitation work funded with low-income housing tax credits. We then performed site visits to the sample units to verify that rehabilitation work shown in the Authority's files had been performed. We also toured the projects to determine whether there had been any significant rehabilitation work performed on other units.

The audit was conducted between August 6, 2007, and January 18, 2008. Our review covered the period October 1, 2002, to December 31, 2006, which corresponds to the financial reporting periods needing restatement of nonprogram income from the Block Grant program.

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:

- The system for calculating and tracking the use of program income and nonprogram income.

- The cost accounting system dedicated to identifying and collecting the cost of individual tasks and assigning those costs to an end unit of production.

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 item is a significant weakness:

- The Authority created policies and procedures for determining program income that did not comply with applicable guidance and regulations. Its definitions of long-term maintenance and rehabilitation were not consistent with OMB Circular A-87 and industry practices. The Authority did not track cumulative NAHASDA rehabilitation or capital expenses for each property, as required, to properly allocate the property's share of income attributable to the Block Grant program.

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use 1/
1B	$174,054
1C	$10,172
Total	$184,226

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. Finding 1B questions $174,054 of the Authority's calculation of nonprogram income for the period July 1, 2002, through December 31, 2006. The questioned amount represents an error in the formula used by the Authority caused by the removal of revenue from 33 units transferred to a low-income housing tax credit program. Finding 1C questions $10,172 in NAHASDA revenue for nine low-rent homes excluded from the Authority's calculation of program income for the period October 1, 2002, through December 31, 2006. The questioned amount represents units removed from the 46 percent of AEL formula because the Authority failed to transition these units to NAHASDA after they were substantially rehabilitated using Block Grant funds.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation **Auditee Comments**

SALISH KOOTENAI HOUSING AUTHORITY
OF THE FLATHEAD RESERVATION

April 10, 2008

Joan S. Hobbs
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General, Region X
Federal Office Building
909 First Avenue, Suite 126
Seattle, WA 98104-1000

RE: Salish and Kootenai Housing Authority comments to draft report

Dear Ms. Hobbs,

In response to the draft report dated March 11, 2008 that was received by our office on March 13, 2008 the Salish and Kootenai Housing Authority (SKHA) would like to submit the following as our formal comments to the draft report. We would like to express our dissatisfaction with the time frame that we were given to respond to the report. To receive a draft report with no forewarning and have a deadline placed on us that does not consider our current workload or duties is unfair to say the least. We have tried to the best of our abilities to study the report and to compile our comments, if we would have had a few more weeks we could have done a better job of clarifying comments made by your auditors and better prepare our response. With that being said we have tried to convey our policies and practices to the best of our abilities given the short amount of time given.

The report begins by first stating in the "subject" line that the SKHA "Did Not Properly Recognize and Account for Program Income from 1937 Act Housing Projects." This statement sounds as if we are neglecting our responsibility as per the NAHASDA regulations. You will see as our comments will show that the SKHA was at the table when the NAHASDA regulations were promulgated and more specifically the regulations on Program Income. We will show that our stance on how we have implemented our position on Program Income as per the NAHASDA regulations is a position that your auditors have failed

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P.O. BOX 38 • PABLO, MT 59855 • 406-675-4491 • FAX 406-675-4495 to understand or consider. I would hope that you would be able to better understand our position and revise the subject line to state that the SKHA has implemented a system to meet NAHASDA regulations. If you do not agree with the position, then your audit can reflect that position, but please don't use language that says that we "do not recognize and account for Program Income" we have a policy and procedure in place and we follow it.

We have no problem with the report language under the heading of "Highlights" for "What We Audited and Why."

Comment 1

We totally disagree with the statements made in the section titled "What We Found." It is interesting that this section is titled "What We Found" and yet it does not mention in any detail or discuss in anyway what your auditors found as to how we calculate program income and our position on long-term maintenance of our 1937 act housing units. It would seem appropriate to discuss in the section what your auditors found, the position that we presented and how we indeed account for program income. What is presented is your auditor's opinion of what they believe to be violations of the regulations and no statements or discussion of our position on the NAHASDA regulations and our policies and procedures that are in place and were explained in great detail to your auditors. The section ends with the statement "These conditions occurred because management created policies and procedures for determining and administering program income that did not comply with applicable guidance and regulations." Again, this statement is an opinion that is not true. We have had monitoring visits from the Denver ONAP office on two separate occasions in the past ten years and during the last monitoring visit we had a specific discussion with the HUD staff on the very issue of program income, how we calculate it and our policies and procedures for long-term maintenance. HUD staff has concurred with our calculations of Program Income and our policies and procedures for long-term maintenance of our 1937 Act housing stock.

We would disagree with the next section titled "What We Recommend." We believe that our policies and procedures are in compliance with NAHASDA regulations and it appears that your auditor's opinion in this issue should require HUD to take this issue back to a Negotiated Rulemaking Session to further define the regulations to meet how your auditors believe the regulations to apply or to look at the issue from our position and concur with us as the Denver ONAP staff have done.

We would disagree with Finding 1 and the justification and issues raised and would offer our position on the remaining document.

Comment 2

The main document that is used when discussing Program Income is HUD Notice PIH 2000-18. It needs to be said and understood that NAHASDA established a program for Indian Tribes and the NAHASDA Statute recognizes the right of Indian self-determination and tribal self-governance (see NAHASDA Section 2. Congressional Findings). From this relationship comes the requirement that all NAHASDA regulations go through a Negotiated Rulemaking Process. HUD Notice PIH 2000-18 was a result of the initial Negotiated Rulemaking process that promulgated all the regulations for NAHASDA. The former Executive Director of the Salish and Kootenai Housing Authority, Mr. Robert Gauthier, was selected to

Comment 3

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Comment 3
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serve on the initial Negotiated Rulemaking Committee. Mr. Gauthier also served on the workgroup that studied the Program Income issue and crafted the document that is HUD Notice PIH 2000-18. We will add underlines of variouss key words for the remainder of our discussion. You will notice that HUD Notice PIH 2000-18 section 3.2 states that Program Income includes, "Income from the use or rental of real property that was acquired, constructed or <u>rehabilitated</u> with IHBG funds and that is owned by the recipient or subrecipient." The SKHA made a policy decision from the beginning of NAHASDA that we would not use IHBG funds to <u>rehabilitate</u> our 1937 act housing stock. In section 3.4 our position becomes very clear. Section 3.4 second paragraph states "To determine how much of the income is program income when the IHBG funds are used for operation and <u>maintenance</u> of rental units..." This is very clear that we only provide maintenance of our 1937 act housing stock.

We provided the documentation that shows our calculation that we compute on a yearly basis. Your auditors found nothing wrong with these documents or questioned the calculations. Section 3.4 goes on to state in paragraph four "When IHBG assistance is used for <u>rehabilitation</u> of a 1937 Housing Act rental unit, the amount of any income to the recipient from such a unit that is attributable to the use of IHBG assistance is related to the cost of <u>rehabilitation</u>." The term used here is rehabilitation and we have made a policy decision to not use IHBG funds for rehabilitation of our 1937 act housing stock. The paragraph goes on further to discuss rehabilitation and states "Again to simplify administration and tracking of funds, a surrogate will be used to represent the cost of <u>rehabilitation</u> or capital expenses for a unit which amounts to <u>substantial rehabilitation or reconstruction</u>." We see this section as a very key piece of what the committee intended rehabilitation to be. This statement clearly defines what rehabilitation is. It states that it is substantial rehabilitation or reconstruction. The rest of the paragraph goes on to discuss the use of the 40% of DC&E when you rehabilitate a 1937 act housing unit using IHBG funds. We made a policy decision that we would not conduct rehabilitation as defined in the fourth paragraph. With that policy decision made we did not track our <u>maintenance</u> expenses because by definition and as discussed in the fourth paragraph of section 3.4 we did not have to and we were not performing <u>rehabilitation</u>, again, as defined in the fourth paragraph.

It seems very evident to us that the committee crafting HUD Notice PIH 2000-18 went to great lengths to distinguish between maintenance and rehabilitation and even went as far as to define rehabilitation. We strongly believe that we have met every aspect of this section of this regulation that was negotiated between HUD and tribal officials.

In an effort to clearly distinguish between what SKHA defines as rehabilitation and maintenance our maintenance manager, Bud Gillin, and myself, took your auditor, [redacted] to a project in a community known as Turtle Lake to show him 33 units that had been rehabilitated. The 33 units at Turtle Lake were substantially rehabilitated or reconstructed using Low Income Housing Tax Credits. We informed [redacted] that we do not receive enough IHBG funds to rehabilitate our 1937 act housing stock therefore when it is necessary to rehabilitate those units we will seek and utilize non-IHBG funds to complete the rehabilitation. We also showed [redacted] units that were of similar age to the Turtle Lake units and there condition by just maintaining the units. We believe that our understanding of HUD Notice PIH 2000-18 clearly shows our implementation of the regulation and our calculation and

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Names of the staff redacted for privacy.

documenting of program income. We believe that our position and discussion presented here should change the audit opinion expressed in relation to the maintenance vs. rehabilitation and the tracking of expense for the 40% of DC&E.

Comment 3
Comment 8

We would also like to address the issue raised in the report under the section titled "NAHASDA – funded Rehabilitation Expenses Not Properly Tracked." In this section your auditors go to great lengths to find a definition to refute our definition of maintenance. Our definition of maintenance as mentioned above is from HUD Notice PIH 2000-18 that was a result of HUD and tribal representatives negotiating the language contained in HUD Notice 2000-18. Your auditors point out the definition contained in OMB Circular A-87 cost principles (2 CFR 225), appendix B, paragraph 25. We agree with the definition contained in appendix B, paragraph 25 and we believe that the definition is very similar to the definition of maintenance contained in HUD Notice PIH 2000-18. As we have stated we do not believe that the maintenance that we perform on our 1937 act housing stock violates appendix B, paragraph 25. I would like to call your attention to the additional definition found in appendix B, paragraph 17 that defines equipment and other capital expenditures. We strongly disagree that our maintenance meets this definition of capital expenditures as the definition states "...expenditures to make improvements to capital assets that materially increase their value or useful life" we have clearly shown that we would use other funding sources to rehabilitate our 1937 act housing stock that would "increase their value or useful life."

Comment 9

We have studied the section titled "Calculation of Nonprogram Income" and your auditor's opinion and discussion on the 33 units at Turtle Lake that we used Tax Credit funding to rehabilitate. Your auditor's opinion is that we failed to remove the 33 units from the AEL calculation back to June 2002. The rehabilitation of the 33 units began in 2002 but the accounting for the units as part of the Tax Credit program did not happen unit 2004, so we believe that our error in not removing them from the AEL calculation should begin in 2004 when the Tax Credit partnership began to receive a Tax Credit benefit for the units and the units were included in a budget for the partnership. We believe that your auditor's program income calculation with the unit count included should use 414 units in 2003 and use 381 units for 2004 and subsequent years. We agree that the units should not be used in the AEL calculation for years 2004 through 2006 and for the future years.

Comment 10

We have an additional error to point out in regards to the program income calculation that we provided your auditors and your auditors failed to point out to us. We went back and reviewed the language and discussions on calculating program income and we found in HUD Notice 2002-12 the information that was contained under the section titled "General Information Related to the OIG Audit." Beginning on page 2 the first paragraph of the page gives an example of if a tribe or TDHE does not have an accounting system to account for program income then all income is program income. The paragraph goes on the state "If the tribe knew how much costs were being paid with the income being generated, the tribe could deduct these costs from the income generated but could not deduct costs paid with IHBG funds." The SKHA failed to deduct these costs. We do have an accounting system that accounts for these expenses separate from IHBG funds. HUD Notice 2002-12 has additional information that clearly states that we should be deducting our costs from our 1937 act housing stock rental income. On

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Comment 10

page 4 of HUD Notice 2002-12 question #7 states "When performing the calculations for 1937 Act Low Rent units, is income net of costs?" The answer give is "Yes. When performing the calculations for the 1937 Act Low Rent units, income is net of costs unless those costs have been paid with IHBG funds." In the program income calculation that we provided the auditors it shows the dwelling rental current year line item. We believe that we should add a line after the dwelling rental current year showing our operation and maintenance costs that should be deducted as per the language contained in HUD Notice 2002-12. A preliminary review shows that those costs would zero out the $174,054 figure reported by your auditors.

Our preliminary review also takes into account the change noted above in regards to the 33 tax credit units and their being removed from the calculation in 2004 and subsequent years. We ask that this error that we have found would revise your auditor's report and that your recommendations to the Denver ONAP would include a directive for us to correct the program income calculation and would include the netting out of our costs associated with the operation and maintenance of our 1937 act housing units and the rental income generated.

Comment 11

In closing we would just like to state that this whole audit process was very informational for us. It seems like the time and expense to perform the audit far exceeded any findings or concerns that were found. It was interesting for us see that your auditors found that the SKHA utilizes all program income and nonprogram income in much the same manner, that all funds audited were spent on housing related activities. It would seem sufficient to us that this should be the end result of the audit and that is what congress intended when NAHASDA was passed and the regulations for the program were negotiated and implemented.

Thank you for your time and consideration of our comments. If you have any questions please feel free to contact Carolyn Welvoda or myself at the SKHA at (406) 675-4491.

Sincerely,

Jason Adams
Executive Director

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OIG Evaluation of Auditee Comments

Comment 1 We discussed the Authority's practices in the section labeled "Results of Audit."

Comment 2 Negotiated rulemaking for the NAHASDA program took place within the constraints of the federal laws and regulations controlling the government grants management process. These standardized rules, applicable to grants from essentially all federal agencies are outside the influence of negotiated rulemaking without prior approval from the Office of Management and Budget (OMB).

Negotiated rulemaking resulted in the NAHASDA regulations at 24 CFR 1000. The supplementary information to this regulation called for a committee to address the need for accounting guidance for program income generated by the combined use of NAHASDA grant amounts and other funds. The product of that committee was PIH Notice 2000-18, which is guidance, not regulation.

Comment 3 The program income subcommittee did not define rehabilitation in any technical terms other than that of capital expenditures, which are defined by OMB Circular A-87 cost principles (2 CFR 225), appendix B, paragraph 25. Also, the Authority's definition of maintenance does not comply with OMB Circular A-87.

Since there is no definition of rehabilitation in the criteria, our position did not attempt to question rehabilitation amounts lower than the Authority's own definition of capital expenditures, or $5,000. The definition of capital expenditures and maintenance are defined by OMB Circular A-87, which is specified by the NAHASDA regulation. The Authority's understanding of this circular is required to maintain the basic administrative capacity to manage a federal grant program.

Authority records clearly demonstrate significant capital expenditures of NAHASDA funds, much higher than this amount, which were not tracked by their system. We observed numerous examples of NAHASDA funded capital improvements to homes, such as replacing windows, siding, roofing, cabinetry, and appliances. Many of these improvements will extend the useful lives and the value of these homes, even at amounts under the Authority's $5,000 capital threshold. Yet, the Authority treated 26 rehabilitations exceeding $20,000 and three rehabilitations exceeding $40,000 as maintenance.

Comment 4 Our results of audit questions the unit counts used in the Authority's calculation of program income, which is the basis for our questioned costs.

Comment 5 Note that the Authority's citation includes the requirement for capital expenditures to be considered in the calculation of substantial rehabilitation.

Comment 6 While there is no clear definition of rehabilitation in the NAHASDA regulations or guidance, the guidance did relate it to other defined terms, such as capital expenditures.

Comment 7 These 33 units were transferred to a Low Income Housing Tax Credit (LIHTC) partnership to obtain significant rehabilitation and modernization. While we acknowledge the Authority's creative efforts to take advantage of other funding opportunities, our review of maintenance contracts revealed that these partnerships were not the only significant capital improvements occurring at the Authority, as identified in our Results of Audit.

Comment 8 We believe it is irrefutable that a $40,000 investment in a property would impact both the useful life and the value of the property and would constitute substantial rehabilitation for any unit maintained by this Authority.

Comment 9 The date used in our calculation was the date the 33 units were transferred to the control of the limited partnership. The Authority proposed using the date the property began earning revenue which is inconsistent with their ownership status and their established practice of segregating revenue by separate balance sheets for the Authority and the tax credit partnerships. If the Authority wants to operate these partnerships within NAHASDA, they would first need to be reviewed and approved by HUD for compliance with established criteria.

Comment 10 The expenses for homes included in this calculation were paid using NAHASDA IHBG grant funds and the nonprogram income was transferred to fund the LIHTC partnership. It is not clear what revenues or expenses are left to offset.

Comment 11 We hope that the Authority continues to pursue creative solutions to affordable housing, both inside and outside of the NAHASDA program. However, as changes in tribal leadership and policy may occur, the purpose of these program income rules is to ensure NAHASDA grant funds continue to reach the intended beneficiaries.