

INTERIM REPORT ON OUTSTANDING AUDIT ISSUES, 2011

Introduction

The finances at Yolo County Housing, as well as the condition of the General Ledger, has been a source of ongoing work since Phil Batchelor was appointed Interim Executive Director in June 2006. Staff at YCH, along with assistance of its outside auditors, have made significant strides in improving the quality of the General Ledger, as well as of file maintenance and improved checks and balances. The effect of these improvements have been demonstrated by the elimination of our “troubled agency” status and, subsequently, by the letter we received from the U.S. Department of Housing and Urban Development (HUD), which finally closes our 2007 audit and audit findings relating to previous years, as well as continuation findings for 2010 that carried over from previous years.

As stated in our staff report, dated 09/16/2010, YCH was interested in hiring the current single audit firm because, “The Reznick Group offered the most comprehensive package to meet the Agency’s needs including experienced personnel, well regarded national firm (IPA “Best of the Best” five of the last six years) with the ability to provide resources unavailable to us with most of the proposers.” Our desire to improve our ability to review our procedures and have a review through “a different set of eyes” to ensure we are doing everything we can to continue to improve is borne out by the finding of our current auditors of 2 Interfund transfers that were not found by the previous auditors.

History and Context

It is necessary to have an overview of the Agency’s history in order to understand the long standing nature of many of the audit findings and the work that has been done by staff:

Summary Look: Here is a look at where we were and where we are.

<u>Indicator</u>	<u>2005-2006</u>	<u>2009-2010</u>	<u>April 2011</u>
Vouchers Under Lease	1259 -\$581,000	1243-\$724,000	1347-\$819,000
On Time Rent Collection	96.58%	97.73%	98.19%
Cash on Hand	\$1.67M	\$3.498M	\$6.367M
Net Income/(Deficit)	(\$2.41M)	\$1.70M	n/a
Administrative Cost	\$5.04M	\$2.20M	n/a

Following is a short chronology of our Agency status *vis-a-vis* the Board, Directors, Audits, HUD and findings:

OVERVIEW of ACTIONS

Date	Actions
June, 2006	BOS takes over BOC. Interim Director. Begin to put funds back into correct accounts. Begins discussion with HUD on the ineligible use of Capital Funds to devise a work out plan. IG opens investigation into Kentucky purchase. HUD disallows capital funds expended on Admin building.
November 20, 2006	Executive Director hired. Forensic investigation continues. Begins scrutiny of line item expenditures and contracts.
February 2007	Cost cutting strategies in place. HUD awards YCH award for "Special Achievement in PHA Administration"
April 2007	TIER Review by HUD's Recovery and Protection Corps. (RPC).
Summer 2007	RPC reclassifies YCH as troubled in operations, LIPH and Financial operations. RPC issues a non-viable entity opinion.
Summer 2007	Budget Ad-Hoc Subcommittee of Helen Thomson and Matt Rexroad. YCH adopts and implements balanced budget, including lay-offs. YCH new single auditors to replace auditors selected by prior management.
Summer 2007	RPC reclassifies the PHA as troubled in all program areas and issues non-viable entity opinion. Is told by HUD that a Capital Fund Financing Plan is required and begins work with YCH to apply.
Summer 2007	Auditor issues "going concern" opinion about non-viability of YCH.
Summer 2007	YCH cuts deficit in half, but does not eliminate it. (Director on board approximately 6 months).
Fall 2007 to Spring 2008	Finance Director hired November 2007. YCH implements ongoing cost containment. Continues with implementation of Asset Management, rolls out additional cost centers to improve cost accounting and oversight.

Summer 2008	YCH approves its second balanced budget. Work continues on the Capital Fund Financing Plan.
February 2009	HUD awards YCH "Most Improved Public Housing Assessment System (PHAS)"
Summer 2009	YCH adopts 3rd balanced budget. Work proceeds with CFFP requirements, including required studies by HUD
March 2010	Capital Fund Financing Plan (CFFP) is approved by HUD. Troubled Agency finding is removed by HUD.
Summer 2010	YCH adopts balanced budget. Cash flow improved by CFFP. Auditors remove the "going concern" finding. Staff begins to move towards resolving the ineligible use of Capital Fund (which is now an approved use through the CFFP approval process) and correcting the General Ledger and Interfund.
Fall 2010	YCH is named a Voucher High Performer. YCH hires current audit team.
January 2011	YCH is named "Public Housing Authority of the Year" by the San Francisco HUD office

Additional Important Chronology Regarding Financials (Property transactions)

In addition to the above, a more detailed review of prior financials shows that YCH/New Hope:

- 2004 - Purchased Kentucky Property through New Hope CDC. Property was sold in November 2007 at a loss in excess of \$600,000. Including operating losses during the period of ownership, the total loss approached \$1,000,000. However, sale was in accordance with appraised value and just slightly under 2004 appraised value. Stopped ongoing cash loss from non-performing property. Ad-Hoc real estate committee: Matt Rexroad and Duane Chamberlain.
- 2005 - New Hope purchased Cottonwood Meadows in 2001. Project was operating with moderate success until November 2005 when the Cottonwood loan was refinanced to pay off the line of credit used to purchase the Kentucky property. Increased debt service cost Cottonwood \$33,000 per year which resulted in program losses and negative cash flow. Property has continued to be difficult to

cash flow.

- 2008 - Due to sale of Kentucky at a loss, New Hope has a large interfund payable to YCH with no resources with which to repay the funds. That Interfund remains open as closing it would mean bankruptcy for New Hope.
- 2010 - In 2002, YCH purchased the property at 147 W Main Street for \$1,090,000 which was paid with a loan for \$940,000 and a down payment of \$150,000 using YCH Capital Funds and without prior HUD approval. 2004 - Additional loans were taken for total of \$2.5M to repay the outstanding loan and fund construction. In addition, Capital Funds were used without HUD approval in the construction of the project. The project was deemed ineligible in 2006. This ineligible project has been corrected and made eligible through a workout with HUD through the CFFP Program.

Cash and Reserves History

In April 2007, the Executive Director recommended, and the Board approved, the retention of forensic accountants. As part of their initial report, Casterline Associates stated,

“Upon our arrival at the Authority, it became clear that the Interfund accounts were in a state of confusion and that the ownership of cash was not clearly defined. We produced a monthly cash report as of May which is now updated monthly that shows the 'ownership' of cash and defines the cash accounts as restricted vs. operating. We also noted numerous questionable accounting issues with the YCH Cash revolving fund including interfund balances with dormant funds, liabilities in the fund and, most importantly, equity in the fund of about \$1.4 million dollars. In general, a revolving fund should have zero liabilities and zero equity. Authority accounting staff could not explain this and referred us to the auditors. We then noted that the auditors, in their 2nd draft of the audit, had consolidated the equity of this fund with the Business Activities fund of the Authority for 2006 but had consolidated it with the Low Income Public Housing program in 2005. After extensive discussions with the auditors, we had this classification changed for the 3rd and final draft of the audit so that this equity of about \$1.4 Million remained with the Public Housing fund. This just demonstrates the confusion and difficulty of the interfund and cash 'ownership' issues not only among YCH accounting staff, but also with the auditors. This is probably due to YCH, in the past, either not understanding or honoring the restrictions on the sources and uses of cash and/or

mismanagement of the general ledger system as it pertains to cash accounting and interfund transactions and reconciliations.”

Reserves Status

<u>Fiscal Year</u>	<u>Public Housing</u>	<u>Sect 8 Funds</u>	<u>Migrant Centers</u>	<u>New Hope</u>	<u>Busn Activities</u>	<u>Grand Total</u>
2003	-108,000	390,000	-29,000	N/a	N/a	253,000
2004	-78,000	-72,000	-218,000	-72,000	110,000	-330,000
2005	57,000	-63,000	-37,000	253,000	-280,000	-70,000
2006	-2,563,000	847,000	19,000	-55,000	-333,000	-2,085,000
Total	-2,692,000	1,102,000	-265,000	126,000	-503,000	-2,232,000

Since that time, YCH has maintained controls on segregated accounts. For 2010, reserve balances were:

2010	685,735	423,704	119,868	14,304	462,246	1,705,857
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For the four year period from 2003 - 2006, the Low Income Public Housing (LIPH) Fund showed a loss of about \$2.7 Million. Note: of this balance, about \$1 .7 Million is related to the ineligible use of capital funds, a contingent liability that was recorded in 2006 and forgiven in 2010. Even without this, the loss in Public Housing Funds was \$1 .0 Million.

General Ledger and Software Issues

Prior to switching to TenMast, the old system had completely crashed and data was not salvageable. For several months, the general ledger was kept on a spreadsheet by the General Services Manager, a non financial professional. That spreadsheet ultimately failed as well.

YCH spent \$225,000 with the firm, PHA Financial, to recreate the general ledger for start-up of the new system. Some long-term staff have said we did not get what we paid for from this contract for accounting services. After this, the General Services Manager was let go and the Deputy Director, another non-financial professional, ran the operation until the hiring of Bob Hencier as Chief Financial Officer.

In 2005, YCH purchased Tenmast as its new integrated software package. The program went live on July 1, 2005. There have been ongoing problems related to its initial set up by

YCH staff (not vendor) with regard to the General Ledger in particular. Staff have been working through these issues, of which interfund transfers are one of the last issues to be resolved. June 27 through June 30, 2011, Tenmast staff have been engaged to provide technical assistance to staff and conduct on-site refresher training to try to isolate and correct these issues (see discussion about inter-funds in Findings Section below).

Remaining Legacy Issues and “new” findings

2010-1: (This finding has been closed by HUD.) We have a combination of systemic issues with TenMast and staff resources within the Finance Department. TenMast is scheduled to be on site for technical assistance to resolve the interfund issues at the end of June 2011. In addition, YCH has implemented the following changes suggested by Reznick to improve segregation of duties:

- Vendor Setup is now being approved by the Finance Director, and
- Finance Director (or Executive Director) approves check registers.
- Keeping a duplicate paper trail for auditors in some cases to facilitate audit requirements.

2010-2: (This Finding has been closed by HUD.) The change to Asset Management has been a driving force in trying to make each AMP work as a freestanding enterprise. This results in better cash flow and meeting federal requirements, but also in having more limited staffing at sites. Limited staff at the AMP sites and the widely dispersed locations prohibit best practice segregation of duties. However, as part of the practice to improve operations, no manager may accept cash payments for rent and rent collections are tallied and reviewed by the supervisor.

In an effort to improve segregation of duties, we have done some research into third party rent collections. To date, we have received estimates of \$2.50 per unit per month and \$9.95 per unit per month. We feel that, at this time of budget uncertainty, that even the \$15,000 annual cost of the lower priced option is not viable. We have asked First Northern Bank for additional information about the pricing of the services they offer. At this time, we don't yet have full information to estimate total cost.

2010-3: (This finding has been closed by HUD.) Complete resolution will take at least one year. As tenants come up for annual or interim recertification, files will be reviewed for completeness and the file checklist that has been developed will be completed, signed and placed in the tenant file. EIV is being used at every annual or interim recertification. Evidence of “EIV received no employment (W-4) data” is being

included in the file.

The Director of Operations and Real Estate Services Supervisor are doing random file reviews to ensure the AMP Managers are documenting tenant files appropriately.

2010-4 & 2010-5: We had identified the interfund account issue and that it seemed to stem from a chronic internal problem. We so notified the auditors at the outset of the audit.

It appears that the way the interfund accounts post to the general ledger has been a problem from the date of the initial system setup in 2005. Each entry creates a Debit or Credit to the originating fund and an opposite entry to the receiving fund and at the same time creates a debit and credit to accounts in the "000" or clearing fund. "000" should always have a net balance of -0-; however it never has.

We have prepared an action plan that includes researching prior period records and receiving technical assistance from our software vendor. We are currently in the research phase of the plan. An on site technical assistance visit is scheduled for the last week of June. The plan has been discussed with Reznick who agree that these steps should lead to resolution of the issue. See below for additional information on these transfers and our response to HUD that outlines our proposed plan of action. This has been agreed to by HUD in its audit letter and also confirmed by our auditors as a prudent course of action:

Interfund Transfers dating from 2006 (from HCV to LIPH: These transfers were not found by our prior two (2) audit firms, but were discovered by our current auditors. They were disclosed in the report to the Board at the April 2011 meeting. They predate the current Director (November 2006), Finance Director(November 2007) , Legal Counsel (June 2006) and Board (June 2006) . We have, as required, disclosed them to HUD.

Discussion and Plan of Action

The issue of Inter-fund Transfers is a very complicated one. Apparently there are 3 separate, but intertwined, issues and all of them relate to the prior management and governance. The issues are as follows:

1. Prior management fund transfers dating from 2006
2. Systemic software problems apparently arising from initial set-up by the prior management that have not yet been corrected (to date we have corrected the General Ledger for off-setting accounts - which took over 2 years to find and correct all of them)

3. Problems that were created when COCC and AMPS were split in 2008 combined with the work out for the Administration Building.

Some examples:

- We found a cash transfer from HCV to LIPH for \$74,000 that occurred in 2006. Because of this and, prior to completing our research, it would appear that \$74,000 is due to HCV from LIPH.
- In March 2006, we found 2 transfers from HCV to the AP/PR account, totaling \$142,436. On June 30, 2006, an entry was made to clear these transfers from the inter-fund balances, but the entry was made backwards and had the effect of appearing to double the amount in the inter-fund account instead of clearing it.
- The entry to separate the Administration Building from LIPH to COCC in 2008 when we split off the AMPS due to asset management created an incorrect automatic system-generated payable of over \$3,000,000. The creation of the new cost center for the Administration Building in 2010 and transfer of the Admin Building balance sheet from COCC to its own cost center will, we believe, eliminate most of the inter-fund receivable. (We are now set up for one cost center for each AMP, plus one for COCC and one for the Administration Building.) But we will need to see if this, indeed clears it, or if there is another, as yet unidentified issue remaining.

We believe that a systemic problem still remains with posting to inter-fund accounts in addition to the items above. In order to clear the items above and to address systemic issues, we are doing the following:

1. Researching transactions from 2006 to be sure we have accounted for all remaining transfer issues (if any) and correcting them - including repayment of any inter-fund balances due.
2. Bringing in technical assistance from the software provider to assist in identifying and correcting the system errors that lead to the chronic and systemic inter-fund posting errors (June 27 - June 30, 2011).
3. Making sure that the work we have done to identify the separate cost centers for the Admin Building, COCC and the AMPS does, indeed, ensure that all fund balances are posted as they should be and correct the erroneous payable.

We are currently in the research phase. We will be ensuring the completion of item #3 as part of the audit and expect to have technical assistance from our vendor during the summer months so that we can coordinate with our auditors as well.

