



U.S. Department of Agriculture
Office of Inspector General
Western Region
Audit Report

RURAL HOUSING SERVICE
FARM LABOR HOUSING PROGRAM
STATE OF CALIFORNIA



Report No. 04601-6-SF
AUGUST 2000



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Western Region - Audit

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DATE: August 16, 2000

REPLY TO

ATTN OF: 04601-6-SF

SUBJECT: Farm Labor Housing Program – State of California

TO: Celeste Cantú
State Director
California State Office
Rural Development

This report presents the results of our audit of the Farm Labor Housing Program in the State of California. Your July 28, 2000, written response to the draft report is included as exhibit B of this report. Excerpts from your response have been incorporated into the relevant sections of the report.

Your written response addressed the discussion draft version of the report rather than the official draft. Based on our discussion at the exit conference, we eliminated Finding No. 4 and Recommendation No. 6 in the discussion draft report, and renumbered the subsequent findings and recommendations (Findings Nos. 5 and 6 and Recommendations Nos. 7 and 8). The official draft report reflected these changes. Please note, therefore, that Issue 4 in your response is no longer applicable, and the numbering of the recommendations cited under Issues 5 and 6 in your response has been changed.

Based on the information that you provided, we accept your management decision on Recommendations Nos. 2, 4, 6, and 7. In order to reach management decision on the report's other recommendations (Recommendations Nos. 1, 3, and 5), please provide the information described in the OIG Position sections of the report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation of these recommendations. Please note that the regulation requires a management decision to be reached on all findings and recommendations within 6 months of report issuance.

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The Office of the Chief Financial Officer (OCFO), U.S. Department of Agriculture, has responsibility for monitoring and tracking final action on the findings and recommendations. Please follow your agency's internal procedures in forwarding final action correspondence to OCFO.

We appreciate the cooperation and assistance provided by your staff during the audit.

/S/
SAM W. CURRIE
Regional Inspector General
for Audit

Attachment

EXECUTIVE SUMMARY

RURAL HOUSING SERVICE FARM LABOR HOUSING PROGRAM STATE OF CALIFORNIA AUDIT REPORT NO. 04601-6-SF

RESULTS IN BRIEF

We performed a review of the Farm Labor Housing (FLH) Program in the State of California as part of a nationwide review of the program. Our objectives were to determine if program borrowers were in compliance with laws and regulations governing the program and evaluate the effectiveness of the Rural Housing Service's (RHS) controls over project operations. We judgmentally selected one project, owned by the Housing Authority of the City of Madera (HACM), for review.

For the project's fiscal years 1996 through 1999, HACM overcharged its FLH project \$35,981 in rent for a maintenance building owned by the housing authority which also served other non-FLH projects HACM owned. The overcharges resulted because HACM lacked an allocation plan to equitably distribute shared costs among its various projects and activities, and did not comply with limitations on the amount of compensation it could charge for the use of property it owns (the costs of which must be recovered through depreciation or a use allowance).

The lack of an allocation plan also resulted in the project being overcharged \$8,567 in office rent and \$9,604 in payroll costs. In the latter case, HACM acknowledged that the overcharge to the FLH project resulted from a funding shortfall in another program. We also found that other administrative costs, such as payroll, maintenance and repair, and travel, were not allocated among HACM's projects and programs in a consistent and equitable manner.

In addition, we found that HACM did not maintain all project funds in approved types (generally, Federally-insured) of accounts, and had operated the project without an approved management plan since the project's inception in the early 1980's.

We are recommending that RHS:

KEY RECOMMENDATIONS

- Require HACM to reimburse its FLH project for overcharges including \$35,981 in maintenance building rent, \$8,567 in office rent, and \$9,603 in payroll costs. Ensure that HACM adheres to limitations on the amount of rent it can charge on its maintenance building.
- Require HACM to develop a cost allocation plan to ensure that shared costs are equitably distributed and to prevent overcharges to the FLH project.
- Require HACM to submit a management plan, if they have not already done so, and complete a review of the plan. Require HACM to update the management plan at least every three years.
- Require HACM to maintain all FLH project funds in approved accounts.

AGENCY RESPONSE

In its July 28, 2000, written response to the draft report, the California State Rural Development Office concurred with the report's findings and recommendations, except for Recommendations No. 1 and 3. The State office suggested we revise these two recommendations to reflect the amounts of rent that HACM proposed (in correspondence to the State office regarding the audit findings) be allowed. The State office included a copy of HACM's correspondence in its response to the audit report (included as exhibit B to this report).

OIG POSITION

We accept Rural Development's management decisions on the recommendations in this report, except for Recommendations No. 1, 3, and 5.

We reviewed the State office's response, including the information provided by HACM. We do not concur with HACM's determination of allowable maintenance building and office rent costs. We disagree with its calculation of maintenance building rent for the following reasons. HACM proposed to depreciate the building and include the cost of improvements in its calculation, but provided no support for the cost of the improvements. HACM proposed to include a number of other costs (equipment depreciation, insurance, utilities, maintenance, and other costs) in its calculation. While these may be allowable costs, they would not be included in a calculation of building depreciation. One other item

they proposed to include -- interest not earned because funds were used to purchase the building -- is not an allowable cost.

Regarding allowable office rent, we also disagree with HACM's proposed amount. Certain costs (insurance, utilities, maintenance, and other costs) included in its calculation may be allowable but not as office rent. We also believe that data we used in our calculations (amount of rent paid and percentage of rent costs chargeable to the project) are more accurate than the figures cited by HACM.

To reach management decision on Recommendations No. 1 and 3, please provide us with a copy of a demand letter to HACM requiring it to reimburse its project \$35,981 for excessive maintenance building rent, \$8,567 for excessive office rent, and \$9,603 for overcharged payroll costs.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
RESULTS IN BRIEF	i
KEY RECOMMENDATIONS	ii
AGENCY RESPONSE	ii
OIG POSITION	ii
INTRODUCTION.....	1
BACKGROUND	1
OBJECTIVES.....	2
SCOPE	2
METHODOLOGY	2
FINDINGS AND RECOMMENDATIONS.....	4
CHAPTER I -- HACM DID NOT PROPERLY ALLOCATE COSTS BENEFITING BOTH ITS FLH PROJECT AND OTHER PROJECTS OR PROGRAMS	4
FINDING NO. 1 -- HACM OVERCHARGED ITS FLH PROJECT FOR MAINTENANCE BUILDING RENT	5
Recommendation No. 1	6
Recommendation No. 2.....	8
FINDING NO. 2 -- HACM OVERCHARGED ITS FLH PROJECT FOR OFFICE RENT	8
Recommendation No. 3.....	10
Recommendation No. 4.....	11
FINDING NO. 3 -- HACM OVERCHARGED ITS FLH PROJECT FOR PAYROLL COSTS	11
Recommendation No. 5.....	12
CHAPTER II -- HACM OPERATED ITS FLH PROJECT WITHOUT A MANAGEMENT PLAN	13
FINDING NO. 4	13
Recommendation No. 6.....	13

CHAPTER III -- HACM DID NOT MAINTAIN ALL PROJECT FUNDS IN FEDERALLY-INSURED ACCOUNTS	15
FINDING NO. 5	15
Recommendation No. 7	15
GENERAL COMMENTS	17
EXHIBITS	
A - SUMMARY OF MONETARY RESULTS	18
B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT	19
ABBREVIATIONS	29

INTRODUCTION

BACKGROUND

The Farm Labor Housing (FLH) program is administered by Rural Development's Rural Housing Service (RHS), and is authorized by sections 514, 516, and 521 of the Housing Act of 1961 (Public Law 87-70), enacted June 30, 1961. The program is designed to provide affordable rental housing to low and moderate income farm workers. FLH projects are to be managed in compliance with RD¹ Instruction 1930-C, Exhibit B, "Multiple Housing Management Handbook."

Loans and grants are made to finance low-rent housing for domestic farm laborers. The funds may be used to build, buy, improve or repair farm labor housing and to provide related facilities. The funds may also be used to buy building sites; purchase basic durable household furnishings; and develop water, sewage disposal, heating and lighting systems. Funds cannot be used to finance debt. As of November 30, 1998, loans totaling \$197 million were outstanding. Fiscal year 1999 appropriations totaled \$20 million.

The FLH is administered through the Rural Development National Office in Washington D.C., and 46 Rural Development State offices. In California, the program is also administered through numerous Rural Development area offices.

Project owners or agents of the owners are responsible for administering their FLH projects in compliance with Rural Development policies and procedures. In return, the owner or its representative may receive a reasonable management fee for its services. Owners are required to report on overall project operations by submitting annual reports to their area office. These reports include (1) an audit report (for projects with 25 or more units); (2) form FmHA² 1930-7, "Multi-Family Housing Project Budget," on which owners estimate income and expenses for the next year and report current year income and expenses; and (3) form FmHA 1930-8, "Year-End Report and Analysis," which includes the project's balance sheet for the current and prior year. Area offices are responsible for

¹ Rural Development

² Farmers Home Administration (FmHA) is the predecessor agency to RHS.

reviewing these annual reports and approving proposed budgets. They also perform supervisory visits to FLH projects at least every three years. These visits include a physical inspection of the property and a review of project records. In addition, area offices are responsible for providing guidance to FLH borrowers in managing project operations.

As of November 30, 1998, RHS' portfolio included 1,049 FLH projects.

OBJECTIVES

The objectives of the audit were to determine if the FLH borrowers were in compliance with the laws and regulations that govern the FLH program and to evaluate the effectiveness of RHS' controls over the FLH projects' operations. Specifically, we evaluated the reasonableness of the FLH projects' operating and maintenance expenses and determined if rent increases were justified by increased project expenditures.

SCOPE

This report was part of a nationwide review of the FLH program. The overall scope of the review was the project's fiscal years 1996 through 1998, but as noted in the findings, in some cases we expanded or reduced the scope.

As of August 25, 1999, California had 67 FLH projects. We judgmentally selected the sample project based on its age and size.

The audit fieldwork was conducted between August and September 1999 at the California Rural Development State Office, the Merced Rural Development Area Office, and HACM's office in Madera. In addition, we performed a site visit to the Madera FLH project managed by the HACM.

The review was conducted in accordance with generally accepted government auditing standards.

METHODOLOGY

To accomplish the overall objectives of the review, we used the following methodology:

- At the State office, we obtained the universe of FLH loans, interviewed staff, and reviewed records to determine the operating procedures and program policies. As a result of these interviews

and record reviews, we judgmentally selected the sample FLH project for review.

- At the area office, we interviewed staff and reviewed the selected project files to evaluate the area office's administration of the FLH program. We reviewed the project's budgets and other financial data to determine if there were any areas that needed emphasis during our review. We solicited input from the area office staff regarding any potential problem areas.
- At the project owner's office, we reviewed project records to determine if the owner had complied with the regulations, policies, and procedures relating to the FLH program. We determined if costs billed to the FLH projects were reasonable, supported and allowable. We also reviewed a sample of tenant certifications. Through physical observation, we evaluated the projects' physical condition and the need for any capital improvements.

FINDINGS AND RECOMMENDATIONS

CHAPTER I	HACM DID NOT PROPERLY ALLOCATE COSTS BENEFITING BOTH ITS FLH PROJECT AND OTHER PROJECTS OR PROGRAMS
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The Housing Authority of the City of Madera (HACM) did not properly allocate costs benefiting more than one housing project or program. This occurred because it lacked an allocation plan to equitably distribute shared costs among its various projects and activities, including its FLH project. As a result, HACM's FLH project was overcharged \$54,550.

Program instructions³ state that the project's "accounting system and/or management plan must document how funds are prorated for revenue and expenses which are not clearly identifiable as being associated with a particular project..." It further states that, in some cases, the agency will consider prorating according to the number of units in each project to be an appropriate basis for prorating funds.

As a local government, HACM must charge costs related to its Federal award in compliance with the provisions of Office of Management and Budget (OMB) Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." This circular requires that shared costs be allocated in an equitable manner. Attachment A, Section C 3 a states that "a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received."

³ FmHA Instruction 1930-C, Exhibit B, paragraph XIII A 1 d, dated August 30, 1993.

FINDING NO. 1

**HACM OVERCHARGED ITS
FLH PROJECT FOR
MAINTENANCE BUILDING
RENT**

HACM overcharged its FLH project for rent on a maintenance building that it owned. HACM did not have support for the amount of rent charged to the FLH project, but we concluded that the percentage of rent it charged to the FLH project was excessive in relation to its other projects. Furthermore, governmental entities (such as the housing authority) are limited in the amount of rent that they can charge on property they own. We estimated that overcharges to the FLH project totaled \$35,981 from July 1995 to June 1999.

OMB Circular A-87⁴ requires that an organization claiming compensation for the use of a building it owns may do so only by claiming either depreciation or a use allowance. If a use allowance is used, no more than two percent of the acquisition cost may be claimed annually.

HACM purchased the maintenance building in January 1994 for \$150,560. The former finance director instructed the staff to charge \$15,000 rent every 6 months (\$30,000 annually) to the various projects, of which \$4,807.50 (\$9,615 annually) was charged to the FLH project. The current finance director was unsure how these amounts were set.

The rent charged to the FLH project equaled about 32 percent of the total rent charged to all the projects. However, the FLH project has 100 units, which is only about 21 percent of the housing authority's 486 units. Since HACM's projects are Federally funded (by either the U.S. Department of Agriculture or the U.S. Department of Housing and Urban Development), HACM is required to adhere to OMB cost principles. While not the only possible basis for allocating costs, we believe that using the percentage of total units would provide a reasonable basis for allocating this type of cost, and we have used it in calculating our estimate of rent overcharges. Because a variety of methods can be used to calculate depreciation, we used a 2-percent use allowance instead of depreciation in our calculations. However, use of depreciation or other allocation methods could result in a different estimate of overcharges.

Between July 1995 and June 1999, HACM charged its FLH project \$38,460 for rent on the maintenance building. As shown in Table 1, we estimated a reasonable amount to charge to all projects for rent to

⁴ OMB Circular A-87, Attachment B, Paragraph 15 d, (dated July 1995)

be \$12,045, of which the FLH project's share would be \$2,479. Based on this figure, we calculated a total overcharge to the FLH project of \$35,981.

Table 1 - Maintenance Building Rent Overcharge to FLH Project

	AMOUNT CHARGED TO FLH PROJECT	2% USE ALLOWANCE ⁵	FLH PROJECT'S SHARE ⁶	AMOUNT OF OVER- CHARGE
7/95 - 6/96	\$9,615.00	\$3,011.20	\$619.70	\$8,995.30
7/96 - 6/97	\$9,615.00	\$3,011.20	\$619.70	\$8,995.30
7/97 - 6/98	\$9,615.00	\$3,011.20	\$619.70	\$8,995.30
7/98 - 6/99	\$9,615.00	\$3,011.20	\$619.70	\$8,995.30
TOTAL	\$38,460.00	\$12,044.80	\$2,478.80	\$35,981.20

RECOMMENDATION NO. 1

Require HACM to reimburse the FLH project \$35,981 for overcharged rent on the maintenance building. If HACM proposes a different amount of reimbursement, based on a different method of calculating the overcharge, ensure that the method it uses complies with regulations and OMB Circular A-87 provisions, and results in an equitable distribution of costs.

Agency Response

Rural Development concurred with the finding and recommendation. However, it disagreed with the amount of the overcharge, and suggested that the amount recommended for collection be revised to an amount determined by HACM. (HACM had provided Rural Development with a written response to the audit finding, which included an amount -- \$8,551 annually -- that HACM proposed it should be allowed to charge the project for maintenance building rent).

Rural Development also agreed with HACM's position it was subject to the provisions of OMB Circular A-87, but not OMB Circular A-122. The draft report had cited both circulars.

⁵ Our computation was based on an acquisition cost of \$150,560 which included the \$30,000 cost of land.

⁶ Based on 20.58% of total units managed.

OIG Position

We agreed with HACM's opinion that it is subject to OMB Circular A-87 but not OMB Circular A-122, and have removed the references to OMB Circular A-122 from the report. We note that both A-122 and A-87 contain similar language, and this change had no effect on our recommendations.

We reviewed Rural Development's response, including the information provided by HACM, and disagreed with their management decision. We do not object to HACM's proposal to recover the building's cost through a 40-year depreciation schedule. However, we do not agree with HACM's proposal to include the other costs shown on its schedule, for the following reasons:

- Improvements could be depreciable, but HACM has provided no support for their cost, which HACM indicates is an estimate. HACM should be able to accurately determine the amount of such costs.
- Equipment depreciation, insurance, utilities, maintenance, and other costs could be allowable costs, but would not be included in the calculation of allowable depreciation on the maintenance building.
- Interest, as described by HACM, is unallowable. We find no provision in the program regulation and OMB Circular A-87, which would allow a borrower to charge an estimate of the interest income it did not earn because it had used funds for other purposes.

In addition, we believe our calculation that 21 percent of the building's cost should be applied to the FLH project is more accurate than HCMA's calculation of 25 percent. HACM's calculation did not reflect all of the units in their senior and migrant projects (Yosemite Manor and Pomona Migrant projects, respectively).

Based on the above, we have not revised the amount we are recommending for collection. In order to reach management decision, please provide us with a copy of demand letter to HACM for the \$35,981 in excessive maintenance building rent it charged to the project.

RECOMMENDATION NO. 2

Require HACM to develop an allocation method for charging future rent expenses that complies with program regulations and OMB Circular A-87 provisions, and results in an equitable distribution of costs.

Agency Response

Rural Development will be meeting with HACM within the next 30 days for compliance. Rural Development will advise HACM that it must develop an allocation method for charging future rent expenses that complies with program requirements.

OIG Position

We accept Rural Development's management decision on this recommendation.

FINDING NO. 2

HACM OVERCHARGED ITS FLH PROJECT FOR OFFICE RENT

HACM overcharged its FLH project for rent on the housing authority's office. This occurred because HACM did not have an allocation plan to fairly share costs among its projects. We determined that \$8,567 was overcharged for fiscal years 1996 through 1998 (July 1995 to June 1998).

Program instructions⁷ state that the project's "accounting system and/or management plan must document how funds are prorated for revenue and expenses which are not clearly identifiable as being associated with a particular project..." It further states that, in some cases, the agency will consider prorating according to the number of units in each project to be an appropriate basis for prorating funds.

In addition to owning and operating FLH and other types of housing projects, HACM also administers the Section 8 program.⁸ At the time of our audit, HACM administered the Section 8 program for 560 participants. Administering the Section 8 program requires significant resources, and the housing authority had several employees who worked on this program alone.

HACM charged its FLH project \$7,981, \$9,477, and \$7,895 in office rents for fiscal years 1996 through 1998, respectively (ending June 1996 through June 1998, respectively). These rents represented

⁷ FmHA Instruction 1930-C, Exhibit B, paragraph XIII A 1 d, dated August 30, 1993.

⁸ Section 8 is a program of the U.S. Department of Housing and Urban Development (HUD).

about 14 to 17 percent of total annual office rent costs for the three years. In our opinion, this was not an equitable distribution of office costs and resulted in overcharges to the FLH program. As shown in the table below (Table 2), we calculated that the FLH units represent under 10 percent of total units administered by the HACM (for purposes of our calculations, we weighed a Section 8 voucher the same as a housing unit, based on the assumption that the resources needed to administer a Section 8 voucher would be equal to or exceed the resources needed to administer a unit of housing).

Table 2 – Percentage Share of FLH Project

PROJECT OR ACTIVITY	NO. OF UNITS OR VOUCHERS	PERCENTAGE SHARE
Section 8	560	53.53
Conventional Projects	260	24.86
Pomona Migrant Project	50	4.78
HACM Relinquishing Account	0	0
Yosemite Manor Project	76	7.27
FLH Project	100	9.56
TOTAL	1,046	100

As shown in the table below (Table 3), we computed the FLH project's share of rent for fiscal years 1996 through 1998 to be \$15,786, resulting in an overcharge to the FLH project of \$8,567. As noted earlier, the use of other assumptions or methods of allocating costs would result in different estimates of overcharges.

Table 3 – Office Rent Charged to FLH Project

YEAR	ANNUAL OFFICE RENT	FLH's SHARE	RENTS CHARGED	OVERCHARGE
1996	\$ 53,040	\$ 5,071	\$ 7,981	\$ 2,910
1997	\$ 55,440	\$ 5,300	\$ 8,477	\$ 3,177
1998	\$ 56,640	\$ 5,415	\$ 7,895	\$ 2,480
TOTAL		\$15,786	\$24,353	\$ 8,567

We also noted that other shared expenses such as administrative salaries, general maintenance and repairs, supplies, and computer services were not allocated between the FLH and other projects in a consistent manner. We concluded that HACM should develop an allocation plan to allocate shared expenses among all its projects and programs in an equitable manner.

RECOMMENDATION NO. 3

Require HACM to reimburse its FLH project for the \$8,567 overcharge for office rent. If HACM proposes a different amount of reimbursement, based on a different method of calculating the overcharge, ensure that the method it uses complies with regulations and OMB Circular A-87 provisions and results in an equitable distribution of costs.

Agency Response

Rural Development concurred with the finding and recommendation. However, it disagreed with the amount of the overcharge, and suggested that the amount recommended for collection be revised to an amount determined by HACM. (HACM had provided Rural Development with a written response to the audit finding, which included an amount -- \$8,958 annually -- that HACM proposed it should be allowed to charge the project for office rent).

OIG Position

We reviewed Rural Development's response, including the information provided by HACM, and disagree with their management decision for the following reasons.

We believe the data we used in our calculations to be more accurate than the data cited by HACM in its calculations. HACM cites a rounded figure for only one year, 1998, whereas our calculation cites actual figures for the 3 years reviewed. Our calculation of the

percentage of total costs applicable to the FLH project (9.56 percent) differs slightly from the percentage determined by HACM (10 percent). While the difference is minimal, we believe our figure to be more accurate. HACM has also proposed to include in its calculations costs other than lease payments (specifically, insurance, utilities, maintenance, and other costs). These costs may be allowable, but not as office rent.

Based on the above, we have not revised the amount we are recommending for collection. In order to reach management decision, please provide us with a copy of a demand letter to HACM for the \$8,567 in excessive office rent it charged to the FLH project.

RECOMMENDATION NO. 4

Require HACM to submit an allocation plan to equitably allocate its shared expenses among its projects and programs.

Agency Response

Rural Development will be meeting with HACM within the next 30 days for compliance. Rural Development will advise HACM that it must develop an allocation plan that will equitably allocate its shared expenses among its projects and programs.

OIG Position

We accept Rural Development's management decision on this recommendation.

FINDING NO. 3

HACM OVERCHARGED ITS FLH PROJECT FOR PAYROLL COSTS

HACM overcharged its FLH project for the payroll costs of one of its employees. Although this employee worked primarily on the Section 8 program, due to a shortfall in that program's funding, the housing authority's former finance director instructed the staff to reallocate the employee's salary from the Section 8 program to other programs. As a result of this reallocation, the FLH project was overcharged up to \$9,604 in payroll costs.

OMB Circular A-87 states that "Any cost allocable to a particular Federal award or cost objective under the principles provided for in

this Circular may not be charged to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law.”⁹

The employee (a receptionist) worked on both Section 8 and housing project related activities. She estimated that she spent at least 75 percent of her time working on Section 8 activities and the other 25 percent of her time on the FLH and other housing projects. However, a memo from the former finance director, dated July 29, 1998, stated that there was a \$32,000 deficit in the Section 8 program, and instructed the accountant to reallocate the employee's payroll costs from the Section 8 program to other programs. The accountant then charged \$9,604 (28 percent) of the employee's payroll cost to the FLH project and the balance to other public housing programs.

Because we were unable to estimate a reasonable amount to be charged to the FLH program for this employee's payroll costs, we are recommending disallowance of the full amount, pending additional information becoming available.

RECOMMENDATION NO. 5

Require HACM to reimburse the FLH for the payroll expense of \$9,604. If HACM proposes to allocate a portion of the employee's salary to the FLH project,

require HACM to provide support for the amount to be charged and ensure that it is reasonable.

Agency Response

Rural Development will be meeting with HACM within the next 30 days for compliance. Rural Development will advise HACM that if it proposes to allocate a portion of the employee's salary to the FLH project, the amount must be reasonable and be based on an indirect cost allocation plan.

OIG Position

In order to reach management decision, please provide us with a copy of demand letter to HACM for the excess payroll expense of \$9,604 it charged to the FLH project.

⁹ OMB Circular A-87, Attachment A, Section C, paragraph 3c (dated 8/29/1997)

CHAPTER II	HACM OPERATED ITS FLH PROJECT WITHOUT A MANAGEMENT PLAN
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FINDING NO. 4

HACM operated its FLH project without a management plan, which is required by program regulations. This occurred due to oversight by both HACM and the RHS area office. Without a management plan, RHS has less knowledge of how the project is being managed and less assurance that it is operating in compliance with program requirements.

RD instructions require borrowers to submit a management plan to the agency for both new and existing projects.¹⁰ According to the instructions, “the objective of a management plan is to describe the property owner’s expectations and standards for performance, timing, and results of management of all aspects of the various components of property operation, maintenance, and compliance with applicable laws and regulations.”¹¹ The plan should be reviewed annually and updated at least every three years by the borrower. Rural Development considers a management plans essential to the successful operation of a project.

Neither the housing authority nor the RHS area office had a valid management plan for HACM’s FLH project in its files. The area office project files contained a copy of a management plan, which appeared to have been prepared in the early 1980’s, when the project was first built. However, the plan was not valid as it had not been signed by either RHS or HACM and was undated. We found no evidence that the project had ever operated under a valid approved plan.

At the completion of our audit fieldwork, HACM told us that it had prepared and was about to submit a management plan to the RHS area office. However, we were unable to verify this.

RECOMMENDATION NO. 6

Require HACM to submit a management plan for its FLH project, if it has not already done so, and complete a review of the plan. Ensure that the plan is updated at least every three years.

¹⁰ FmHA Instructions 1930-C, Exhibit B, paragraph (V)(A)(1), dated August 30, 1993.

¹¹ FmHA Instructions 1930-C, Exhibit B-1, dated August 30, 1993.

Agency Response

Rural Development has received and approved a management plan from HACM for its FLH project. Rural Development will ensure that the management plan is updated at least every three years.

OIG Position

We accept Rural Development's management decision on this recommendation.

CHAPTER III	HACM DID NOT MAINTAIN ALL PROJECT FUNDS IN FEDERALLY-INSURED ACCOUNTS
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FINDING NO. 5

HACM did not maintain all FLH project funds in Federally-insured accounts, as required. This occurred because HACM wanted to obtain a higher rate of return on a portion of the project's funds. As a result, project funds may have been subjected to a higher level of risk than allowed by program regulations.

Program instructions allow reserve funds to be invested but specify that only certain types of investments be allowed. Allowable investments include accounts at Federally-insured institutions, obligations of the U.S. Treasury Department, securities backed by the U.S. Government, and triple-A rated Government National Mortgage Association bonds.¹²

At the time of our audit, HACM had invested \$49,529 in FLH project funds in a "Local Agency Investment Fund" (LAIF) not insured by an agency of the Federal Government or collateralized by the bank. The LAIF is a voluntary State program created to be an alternative form of investment for California's local governments and special districts. These securities were not insured, and therefore, could not be used as investments for program funds.

RECOMMENDATION NO. 7

Require HACM to maintain all FLH project funds in accounts meeting the requirements of program regulations. Ensure that HACM has transferred all project funds to such accounts.

Agency Response

Rural Development will be meeting with HACM within the next 30 days to ensure that it has transferred all project funds to a Federally insured institution.

¹² FmHA Instruction 1930-C, Exhibit B, paragraph XIII B 2 c (2) iii, dated August 30, 1993.

OIG Position

We accept Rural Development's management decision on this recommendation.

GENERAL COMMENTS

The bank that holds HACM's FLH project reserve account could not locate the signature card for the account, and the copy of the signature card held by the housing authority was obsolete. It contained the signature of the former, not the current, executive director. An HACM official acknowledged that HACM had forgotten to provide an updated signature card to the bank after there had been a change of HACM director. This omission remained undetected because there have been no reserve account withdrawals since the prior executive director left. The official told us that HACM would submit a new signature card signed by the new executive director and an appropriate RHS official.

EXHIBIT A - SUMMARY OF MONETARY RESULTS

RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	Overcharged Rent on Maintenance Building	\$35,981	Questioned Cost, Recovery Recommended
3	Overcharged Rent on Office	\$8,567	Questioned Cost, Recovery Recommended
5	Misallocation of Payroll	\$9,604	Questioned Cost, Recovery Recommended
TOTAL MONETARY RESULTS		\$54,152	

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT



Rural Development
UNITED STATES DEPARTMENT OF AGRICULTURE
Celeste Cantú, State Director
Business . Housing . Utilities

430 G Street, Agcy 4169
Davis, CA 95616-4169
Phone: (530) 92-5800
FAX: (530) 792-5837
TDD: (530) 792-5848

July 28, 2000

SUBJECT: Audit for Farm Labor Housing Program, State of California
Audit Report No. 04601-6-SF

TO: Mr. Sam Currie, Regional Inspector General
Office of Inspector General
Western Regional Office
75 Hawthorne St. #200
San Francisco, CA 94105

This will provide our response to the discussion draft report and exit conference for the subject audit. The six areas of findings and recommendations are:

1. The Housing Authority of the City of Madera (HACM) overcharged its Farm Labor Housing (FLH) projects for maintenance building rent.
2. HACM overcharged its FLH project for office rent.
3. HACM overcharged its FLH project for payroll costs.
4. HACM charged the unapproved cost of automobile purchases to its FLH project.
5. HACM operated its FLH project without a management plan.
6. HACM did not maintain all project funds in federally insured accounts.

Our response to each of these areas is:

Issue 1. Housing Authority of the City of Madera (HACM) overcharged its Farm Labor Housing (FLH) projects for maintenance building rent.

Recommendation No. 1

HACM has provided a legal opinion that they are not subject to OMB Circular A-122; they are not a non-profit entity. They agree that they are subject to OMB Circular A-87.

Attached is their interpretation of what is allowable under A-87 (ATTACHMENT 1-A). The schedule they provided adds depreciation, interest and other costs to arrive at \$8,551.16 (ATTACHMENT 1-B).

Supporting information documents that they charged \$8,551.16 per year for maintenance building rent; they did not charge the \$9,615.00 per year as projected by OIG.

We concur in both the findings and recommendations of this section. However, based on the supporting documentation provided, we suggest that Recommendation No. 1 be revised and the FLH project's share of rent be recalculated as outlined above.

"The People's Department"
Rural Development is an Equal Opportunity Lender, Provider and Employer:
Complaints of discrimination should be sent to:
USDA, Director, Office of Civil Rights
Washington, D.C. 20250

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

2

Issue 1. Housing Authority of the City of Madera (HACM) overcharged its Farm Labor Housing (FLH) projects for maintenance building rent. (Continued)

Recommendation 2

We concur in both the findings and recommendation of this section. We will be meeting with the borrower within the next 30 days for compliance. We will advise that HACM must develop an allocation method for charging future rent expenses that complies with regulations and OMB Circular A-87 provisions, which will result in an equitable distribution of costs.

Issue 2. HACM overcharged its FLH project for office rent.

Recommendation 3

HACM has provided a legal opinion that they are not subject to OMB Circular A-122 because they are a non-profit entity. They agree that they are subject to OMB Circular A-87.

Attached is their interpretation of what is allowable under OMB Circular A-87 (ATTACHMENT 1-A). The schedule they provided includes depreciation, interest and other costs, to arrive at \$8,958.15 (ATTACHMENT 1-B). Supporting documentation reveals that the \$17,510.00 includes the maintenance building charge mentioned in Finding 1 above. Therefore, the charge for office rent should be \$8,958.84. (\$17,510.00 minus \$8,551.16 = \$8,958.84).

We concur in both the findings. However, based on the supporting documentation provided, we recommend that the recommendation be revised and FLH project's share be recalculated on the basis mentioned above.

Recommendation 4

We concur with the findings and recommendation of this section. We will be meeting with the borrower within the next 30 days to ensure that the approximate allocation plan be fully understood and complied with in a timely manner.

Issue 3. HACM overcharged its FLH project for payroll costs

Recommendation 5

We concur in both the findings and recommendation of this section and will be meeting with the borrower within the next 30 days for compliance. We will advise HACM that if it proposes to allocate a portion of the employee's salary to the FLH project, HACM must provide supporting documentation based on an indirect cost allocation plan for the amount to be charged and ensure that it is reasonable.

Issue 4. HACM charged the unapproved cost of automobile purchases to its FLH project.

Recommendation 6

We do not concur with this finding or the recommendation of this section for the following reasons:

The vehicles are now eight years old. OIG noted that two passenger vehicles were reported on the FLH project's fixed asset inventory records. The two 1991 Mitsubishi Mirages were purchased by HACM for \$18,361 in June 1992. However, there are no available accounting records or purchase receipts of any kind that establish that these vehicles were purchased with Rural Development funds. We do not feel that this is a practicable course of action at this time.

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

Issue 5. HACM operated its FLH project without a management plan.

Recommendation 7

We concur with the findings and recommendation of this section. We have received and have approved a management plan for its FLH project. We will ensure that the plan is updated at least every three years.

Issue 6. HACM did not maintain all project funds in federally insured accounts

Recommendation 8

We concur with the findings and recommendation of this section. We will be meeting with the borrower within the next 30 days to ensure that HACM has transferred all project funds to a Federally insured institution. The new executive director and an appropriate Rural Development official has signed a signature card for the account and that it is filed with the appropriate bank that holds HACM's FLH project reserve account.

Please contact Millie Manzanedo, Multi-family Housing Coordinator, telephone number (530) 792-5819, if you have any questions or require additional information.

Sincerely,



CELESTE CANTÚ
State Director

Attachments

Cc: Administrator, Rural Development, Washington, D.C., Attn: MFHC
Director, Planning and Analysis Staff, Washington, D.C.

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

ATTACHMENT 1-A

HOUSING AUTHORITY
of the
CITY OF MADERA
CALIFORNIA

CHRISTINE RICHARD
Executive Director



March 24, 2000

Mr. Richard Brassfield
Rural Development Director
United States Department of Agriculture
4625 W. Jennifer Street, Suite 126
Fresno, CA 93722

Re: Application of "Cost Principles for State, Local and Indian Tribal Governments",
OMB Circular A-87

Dear Mr. Brassfield:

Enclosed is a copy of an internal memorandum from Joseph Soldani, our attorney, to Christine Richard, our Executive Director. In the content of the memorandum, you will find that our attorney is of the opinion that OMB Circular A-87 is applicable in our case for the reasons therein. I, as well as our Executive Director, agree.

It is very clear that OMB Circular A-122 does not apply to a local government, which is our organizational structure. I have also enclosed 24CFR85.22, entitled "[a]llowable costs", under Title 24, Housing and Urban Development of the Code of Federal Regulations, which supports our position.

Furthermore, the "Rental costs" approved by your office for the fiscal years under the scope of the OIG audit are clearly allowable expenses under OMB Circ. A-87, section 38.c., which states,

"Rental costs under less-than-arms-length leases are allowable only up to the amount that would be allowed had title to the property vested in the governmental unit. For this purpose, less-than-arms-length leases include, but are not limited to, those where: (1) One party to the lease is able to control or substantially influence the actions of the other; (2) Both parties are parts of the same governmental unit; or (3) The governmental unit creates an authority or similar entity to acquire and lease the facilities to the governmental unit and other parties."

Under section 38.d. of OMB Circ. A-87, the regulations allow,

"Rental costs under leases which are to be treated as capital leases under GAAP

205 NORTH "Q" STREET • MADERA, CA 93637 • (559) 674-5695

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

Letter to Mr. Richard Brassfield, Rural Development Director, USDA, March 24, 2000, page 2

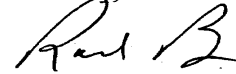
are allowable only up to the amount that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. This amount would include expenses such as depreciation or use allowance, maintenance, and insurance. The provisions of Financial Accounting Standards Board Statement 13 shall be used to determine whether a lease is a capital lease.

Interest costs related to capital leases are allowable to the extent they meet the criteria in section 26."

For your review, I will provide a schedule of detailed items supporting the allowable rental costs for fiscal year end 1998 pursuant to OMB Circular A-87, section 38, by fax, later this morning.

If you would like to discuss this matter further, please give me a call at (559) 674-5695 ext. 237.

Sincerely,



Roel Briones
Financial Services Manager

Enclosures

cc: Christine Richard, Executive Director
Joseph Soldani, Housing Authority Attorney
Debbie Morris, Rural Development Manager

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

City of Madera
InterOffice Memo
City Attorney's Office

March 23, 2000

To: Christine R. Richard, Madera Housing Authority

Subject: Applicability of OMB Circular A-122 To Housing Authority Farm Labor Project

This is written to confirm your understanding that OMB Circular A-122 ("A-122") is not the Circular that applies to the Housing Authority of the City of Madera.

A-122 is entitled-"Cost Principles for Non-Profits." OMB Circular A-87 (A-87) is entitled "Cost Principals for State, Local and Indian Tribal Governments..."

As you know, A-122 provides in its preface as follows:

Purpose. This Circular establishes principles for determining costs of grants contracts and other agreements with non-profit organizations. It does not apply to ...**State, local**, and federally-recognized Indian tribal governments which are covered by OMB Circular A-87. "Cost Principles for State, Local and Indian Tribal Governments..."[Underlining and Bold added.]

...For this purpose, the term "non-profit organization" excludes...State, local, and federally-recognized Indian tribal governments..."
[Underlining added.]

A-87 on the other hand provides as follows:

Purpose. This Circular establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments (government units).

...These principles will be applied by all Federal agencies in determining costs incurred by governmental units under Federal awards (including subawards).

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

Christine Richard
March 23, 2000
Page 2

By its express terms A-122 does not apply to State and local government agencies while A-87 does.

Additionally, 28 CFR 85.22 provides specific authorization for the use of A-87 as follows:

...For each kind of organization, there is a set of Federal principles for determining allowable costs. Allowable costs will be determined in accordance with the cost principles applicable to the organization incurring the costs.

...For the costs of a ...state, local or Indian tribal government... Use the principles in OMB Circular A-87.

The Federal Regulations and Circulars recognize that costs principles must be applied based upon the type of organization. The regulators recognize the difference in the structure and function on different types of organizations.

In the California Supreme Court Case of *Housing Authority of City of Los Angeles v. City of Los Angeles et al.* (1952) 38 Cal.2d 853, the court in addressing the nature of the Housing Authority of the City of Los Angeles made it clear that Housing Authorities are governmental agencies when it stated the following:

Our state legislature meeting in extraordinary session in 1938 enacted the Housing Authorities Law, Stats.1938, Ex. Sess., p. 9, as amended; now sec. 34200 et seq. of the Health and Safety Code. . . . In the same year through action of the city council, the 'Housing Authority of the City of Los Angeles' was organized to function as the creature, however, of the state legislative action. . . . The housing authority was thereby created as a state agency, 'a public body corporate and politic'

The Housing Authority of the City of Madera was created under the same enabling legislation and with the same process as the Housing Authority of the City of Los Angeles. It is by law a State Agency operating under the purview of the City of Madera.

In all other programs in which the Housing Authority receives and uses Federal grant or loan funds it has historically used Circular A-187.

Furthermore all audits of the Housing Authority Programs submitted to all State and

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

Christine Richard
March 23, 2000
Page 3

Federal awarding agencies have always been based on the Principles of A-87 and not A-122.

Based on the foregoing, it is the opinion of this office that A-87 is the Circular that contains the accounting principles that apply to the Housing Authority and not A-122.

Should you have any questions concerning this matter please contact this office at 675-0855.

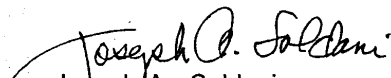

Joseph A. Soldani
City Attorney

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

U.S. GOVERNMENT PRINTING OFFICE

<http://irwebgate.access.gpo.gov/cgi-bin/...&PART=85&SECTION=22&YEAR=1998&TYPE=TEXT>

[Code of Federal Regulations]
[Title 24, Volume 1, Parts 0 to 199]
[Revised as of April 1, 1998]
From the U.S. Government Printing Office via GPO Access
[CITE: 24CFR85.22]

[Page 403-404]

TITLE 24--HOUSING AND URBAN DEVELOPMENT

PART 85--ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE,

Subpart C--Post-Award Requirements

Sec. 85.22 Allowable costs.

(a) Limitation on use of funds. Grant funds may be used only for:
(1) The allowable costs of the grantees, subgrantees and cost-type contractors, including allowable costs in the

[[Page 404]]

form of payments to fixed-price contractors; and

(2) Reasonable fees or profit to cost-type contractors but not any fee or profit (or other increment above allowable costs) to the grantee or subgrantee.

(b) Applicable cost principles. For each kind of organization, there is a set of Federal principles for determining allowable costs. Allowable costs will be determined in accordance with the cost principles applicable to the organization incurring the costs. The following chart lists the kinds of organizations and the applicable cost principles.

For the costs of a--	Use the principles in--
State, local or Indian tribal government..	OMB Circular A-87.
Private nonprofit organization other than an (1) institution of higher education, (2) hospital, or (3) organization named in OMB Circular A-122 as not subject to that circular.	OMB Circular A-122.
Educational institutions.....	OMB Circular A-21.
For-profit organization other than a hospital and an organization named in OMB Circular A-122 as not subject to that circular.	48 CFR part 31. Contract Cost Principles and Procedures, or uniform cost accounting standards that comply with cost principles acceptable to the Federal agency.

EXHIBIT B - RURAL DEVELOPMENT'S WRITTEN RESPONSE TO THE DRAFT REPORT

ATTACHMENT 1-B

Warehouse
Lake Street Maintenance
T: 01147502

Item	Life (months)	Date	Cost
Property		01/31/94	150,560.00
Improvements (est)			75,000.00
Building			225,560.00
Equipment			10,000.00
Land			30,000.00

1998 Annual Cost to operate warehouse

Type of cost	Comments	Cost
Bldg- depreciation	40 year life	3,014.00
PPE-depreciation	10 year life	1,000.00
Improvements-depr	20 year life	3,750.00
Interest	Cost of property (\$150,560) x Market interest rate (7.5%)	11,292.00
Property Insurance	Insurance premium (.079%) x Property value (\$165,485.00)	130.73
Liability Insurance	Liability premium (estimate 75 % of property insurance)	98.05
Utilities	Electric, gas, water and sewer	5,309.86
Maintenance	Approximate costs	6,000.00
Other costs		3,610.00
Total		34,204.64
Farm Labor Allocation (from below)		25%
Rental Cost to Farm Labor Line 20		8,551.16

Costs of warehouse allocated by unit allocation:

Farm Labor	100 Units	25%
Public Housing	260 Units	65%
Other Uses	40 Units	10%
Total Units Allocated	400 Units	100%

OFFICE

1998 Annual Cost to Operate Office

Type of cost	Comments	Cost
Lease payments		57,000.00
Other costs		15,000.00
Property Insurance		200.00
Liability Insurance		200.00
Utilities		5,681.54
Maintenance	approximately	11,500.00
Total		89,581.54
Farm Labor Allocation (from below)		10%
Rental Cost to Farm Labor Line 20		8,958.15

Allocation of Cost

Farm Labor	100 Units	10%
Public Housing	260 Units	26%
Section 8	520 Units	52%
Other Uses	120 Units	12%
Total Units Allocated	1000 Units	100%

Total Rent charged to Farm Labor

17,509.31

ABBREVIATIONS

FLH	Farm Labor Housing
FmHA	Farmers Home Administration
HACM	Housing Authority of the City of Madera
OMB	Office of Management and Budget
RD	Rural Development
RHS	Rural Housing Service