Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump
*Making government work better*

Official Audit Report–Issued March 11, 2014

# Hopedale Housing Authority

For the period October 1, 2010 through December 31, 2012

March 11, 2014

Nancilee Fuller, Chair
116 Hopedale Street
Hopedale, MA 01747

Dear Chairwoman Fuller:

I am pleased to provide this performance audit of the Hopedale Housing Authority. This report details the audit objectives, scope, methodology, findings, and recommendations for the audit period, October 1, 2010 through December 31, 2012. My audit staff discussed the contents of this report with management of the Authority, and their comments are reflected in this report.

I would also like to express my appreciation to the Hopedale Housing Authority for the cooperation and assistance provided to my staff during the audit.

Sincerely,

Suzanne M. Bump
Auditor of the Commonwealth

# TABLE OF CONTENTS

# EXECUTIVE SUMMARY

The Hopedale Housing Authority, a public body politic and corporate, is charged with providing decent, safe, and sanitary dwellings within the financial reach of elderly/handicapped persons of low income. The Authority was organized and established in March 1961, when the Town of Hopedale recognized the need for a housing authority to address the shortage of safe, sanitary dwellings in the town for persons of low income. The Authority is authorized by and operates under Chapter 121B, Section 3, of the Massachusetts General Laws and operates under the oversight of the Department of Housing and Community Development (DHCD), which is the state agency charged with the oversight of state-funded housing authorities. A five-member board of commissioners is responsible for the Authority's governance. A part-time executive director, reporting to the board, is responsible for the day-to-day management of the Authority. The Authority also employs two part-time maintenance workers and an outside fee accountant.

The objectives of our audit were to review and analyze the internal controls the Authority had established over the following selected activities: budgeting; accounting and financial reporting; tenant selection; rent determination; inventory of fixed assets; procurement of goods and services; contract management; program site inspections; management of cash and investments; turnover of vacant units; management of accounts receivable; payroll and fringe benefits; administrative expenses such as travel and credit-card expenditures and related-party transactions; and compliance with applicable laws, regulations, policies, procedures, and other guidance related to these activities.

### *Summary of Findings*

- Expenditures totaling $312,288 for five roof replacements ($302,788) and a central air-conditioning system ($9,500) were not capitalized, recorded as assets on the Authority's balance sheet, and depreciated over the useful life of the assets. As a result, the Authority's accounting records and its financial reports related to these assets were inaccurate.

- The Authority could not provide supporting documentation for the balance of $56,749 in the Furniture, Equipment and Machinery—Dwellings control account reported on its balance sheet during the audit period. As a result, this balance cannot be relied on.

- The Authority did not prepare an invitation to bid or a request for proposals for door replacements with an original price of $25,200 (greater than the $25,000 requiring written or oral quotes) or advertise for bidding as required by the General Laws. As a result, the Authority cannot be sure that it paid the best price for this work.

- Two of 12 tenants' rents we reviewed were not in compliance with the established guidelines for continued occupancy because their rents, calculated using 30% of their income, exceeded fair market rents for the region. Authority management did not evict these tenants and did not apply for the necessary waivers required by DHCD regulations to set aside the eligibility requirements. The Authority has a tenant waiting list, and there may be people on the list who are in greater need, based on income, of the space currently occupied by these two tenants.

- The Authority has not documented an adequate capitalization policy for fixed assets. As a result, fixed assets might not be properly accounted for, and the Authority's financial data might not be correctly reported.

- The Authority has not established a formal policy to adequately control its inventory of capitalized and non-capitalized furniture, equipment, and machinery. As a result, we could not verify the completeness and accuracy of inventory or rely on the completeness and accuracy of the documentation provided to support non-capitalized inventory; fixed asset balances might not be accurately stated on the Authority's balance sheet; and non-capital inventory might not be adequately safeguarded against loss, theft, or misuse because the Authority cannot verify that the inventory is accurate and complete.

- The Authority's policies and procedures and management plan were last updated and approved by the board of commissioners in January 2003. As a result, employees might not be using the most up-to-date information to guide them in their work; this can result in inefficient operations and the allocation of more resources to a task than necessary.

- The contracts for the Authority's executive director and outside fee accountant expired in January 2012 and September 2011, respectively. Without current, signed contracts, the Authority cannot be certain that the obligations of the involved parties are clearly stated and agreed upon.

- Accrued compensated absences[1]—current and non-current portions—were not accurately reported on the Authority's balance sheet in fiscal years 2011 and 2012. Vacation accrual was overstated by $933 in fiscal year 2011 and $1,467 in fiscal year 2012. Sick leave accrual was understated by $10,487 in fiscal year 2012. Therefore, overall, financial reporting to interested parties such as DHCD and the board is not accurate. In addition, incorrectly recorded sick time totals may deny employees a cash benefit to which they are entitled upon retirement.

- The executive director accrued more vacation time than permitted by her contract without approval from the board of commissioners. As a result, the executive director may have received unallowable vacation time.

### *Recommendations*

- To ensure that the financial statements are accurately stated, the fee accountant should correct the Authority's financial records to include the fixed assets in question as required by proper accounting guidelines outlined in DHCD's Accounting Manual for State-Aided Housing Programs (the Accounting Manual) and by generally accepted accounting principles. The fee

[1] This term refers to any type of paid leave.

accountant should also prepare the appropriate adjusting entries for the related depreciation expense.

- The Authority should perform an analysis of the Furniture, Equipment and Machinery—Dwellings control account to determine what the correct balance should be. It should also prepare an adjusting entry to record the correct amount based on the analysis performed and should ensure that there are verifiable supporting records for the total amount recorded in the Furniture, Equipment and Machinery—Dwellings control account. On an ongoing basis, at least annually, the Authority should perform an analysis of the balance in the account (e.g., by performing a physical inventory) and keep a physical record, if necessary.

- The Authority should ensure that every contract for construction, labor, and materials fully complies with the requirements detailed in Chapter 149, Sections 44A – 44J, of the General Laws.

- If the Authority decides to request waivers from DHCD to set aside eligibility requirements for occupation of some units, it should submit its requests immediately. It should also work with the board of commissioners to develop a contingency plan in case DHCD does not approve the waivers and the tenants need to be given eviction notices.

- The Authority should develop and implement a comprehensive capitalization policy that models the guidelines in the suggested policy in Sections 16(A), 16(B), and 16(C) of the Accounting Manual.

- The Authority should establish the existence and valuation of its non-capital inventory costing $1,000 and more to start the internal control process. Inventory records should be updated in a timely manner when a requisition or a disposition of an asset occurs, physical inventory should be taken at least annually, and inventory records should be adjusted to reflect the physical inventory amounts. All adjustments should be recorded on the Authority's books to ensure that the physical count matches the inventory records.

- The Authority should immediately update its policies, procedures, and management plan as required by DHCD guidelines and should obtain board approval of those documents. It should also ensure that the documents are reviewed in a timely manner, at least annually, in accordance with sound business practices; updated if necessary; and approved by the board.

- The board of commissioners and the executive director should establish new contracts for the executive director and the fee accountant, if they still desire to retain these people, as required by the Authority's policies and procedures.

- The fee accountant should make the necessary adjustments to correct the vacation accrual and record the vested sick time accrual. In the future, the Authority should consider reviewing the final accrual number before recording to ensure that the information recorded is accurate, complete, and in compliance with the contract agreement and the Authority's policies and procedures. It should also ensure that the accruals are properly split between current and long-term liabilities on the balance sheet to accurately reflect proper classification of the amounts.

### *Post-Audit Action*

As a result of the audit, the Authority's fee accountant correctly capitalized in the Authority's accounting records the roofs and central air-conditioning system in the amount of $312,288.

# OVERVIEW OF AUDITED AGENCY

### *Background*

The Hopedale Housing Authority is a small housing authority with 80 one-bedroom units for low-income elderly/handicapped residents. It is located at 116 Hopedale Street in the town of Hopedale, Massachusetts. The mission of the Authority, a public body politic and corporate, is to provide low-income elderly/handicapped residents with decent, safe, and sanitary housing within their financial reach. The Authority was organized and established in March 1961, when the Town of Hopedale recognized the need for a housing authority to address the shortage of safe, sanitary housing in the town for persons of low income.

The Authority is authorized by and operates under Chapter 121B, Section 3, of the Massachusetts General Laws, Department of Housing and Community Development (DHCD) regulations, and Title 760 of the Code of Massachusetts Regulations. DHCD is the agency that has oversight of the Massachusetts housing and community development programs and of state-funded housing authorities. DHCD enters into agreements with local housing authorities (LHAs) to plan, design, construct, manage, and administer programs to provide housing for persons of low income within the Commonwealth. The agreement between DHCD and an LHA for the development of new housing is known as the contract for financial assistance. This agreement gives a general overview of the scope of the LHA's responsibilities during the development and management periods and specifically details how these responsibilities are to be executed.

A five-member board of commissioners is responsible for governance of the Authority. Four of the board members are elected, and one member, the state appointee, is appointed by the governor of Massachusetts. The state-appointee position has been vacant for the past five years. The board hired a part-time executive director to manage the Authority's day-to-day operations, and the executive director provides the board with monthly financial reporting. The Authority also employs two part-time maintenance workers and has hired an outside fee accountant to provide accounting services.

# AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted a performance audit of certain activities of Hopedale Housing Authority for the period October 1, 2010 through December 31, 2012. In some cases, it was necessary to test data outside this audit period in order to meet our audit objectives.

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

The objectives of our audit were to review and analyze the internal controls the Authority had established over the following selected activities: budgeting; accounting and financial reporting; tenant selection; rent determination; inventory of fixed assets; procurement of goods and services; contract management; program site inspections; management of cash and investments; turnover of vacant units; management of accounts receivable; payroll and fringe benefits; administrative expenses such as travel and credit-card expenditures and related-party transactions; and compliance with applicable laws, regulations, policies, procedures, and other guidance related to these activities.

To accomplish our objectives, we performed the following audit procedures:

- To determine whether the Authority's DHCD-approved budgets accurately reflected anticipated revenues and expenditures and were prepared in compliance with applicable DHCD rules and regulations, we obtained the financial information from DHCD's Housing Authority Financial Information System (HAFIS) for the audit period and compared budgeted amounts to actual expenditures, looking for significant variances (10% or more). We obtained explanations for variances and assessed reasonableness based on the understanding we had gained about the auditee during planning. We verified that budgets were prepared in accordance with the applicable DHCD budget guidelines; were certified by the board; and were submitted to DHCD within the timeframes stipulated in the budget guidelines. We also reviewed the reports for accuracy and completeness, and where appropriate, we confirmed that the general ledger matched the financial statements.

- To determine that operating reserves were adequate based on DHCD guidelines, we obtained the operating reserve analysis from HAFIS for the audit period and verified that the amounts from the analysis were accurate for the line items stated by cross-checking the other schedules referred to. We recalculated these amounts for accuracy. We verified percentages for the applicable budget guidelines and recalculated those amounts for accuracy. We verified the overall accuracy of the Authority's operating reserves and confirmed that they fell within DHCD's provisions for maximum and minimum allowable amounts. We also used the operating reserves' numbers to verify that the level of need for operating subsidies was accurately calculated.

- To determine whether the Authority was collecting the requested financial and management information and reporting it to DHCD on a timely basis, we interviewed the Authority's executive director, reviewed information submitted to DHCD in HAFIS, reviewed information for accuracy and timeliness during vacancy testing, compared budgeted revenues and expenditures to actual revenues and expenditures, reviewed tenants' accounts-receivable records, and reviewed data-collection information submitted to DHCD and stored in the Authority's files. (DHCD approves and returns some documents to the Authority for its files. Section 7 of DHCD's Accounting Manual for State-Aided Housing Programs [the Accounting Manual] details the accounting data that the Authority is required to report to DHCD.)

- To determine whether the Authority's tenant selection was compliant with applicable DHCD regulations, we selected a sample of tenants and analyzed the appropriate information for eligibility such as income verification and proper maintenance of the prospective tenants' waiting list. We checked to determine whether the prescribed forms were being used and whether tenants were housed in the correct order based on preference and priority. We performed appropriate tests to determine compliance with DHCD regulations and 760 Code of Massachusetts Regulations (CMR) 5.

- To determine whether rental income and any other income generated by the Authority were accurate, complete, and properly recorded, we selected a sample of rent determinations and recalculated for accuracy and compliance based on the guidelines provided in DHCD regulations and 760 CMR 6. We compared calculated amounts with supporting documents and required forms on file for completeness and accuracy. We confirmed that rent redeterminations were being calculated annually to determine whether rents charged continued to be accurate and whether tenants continued to meet the fair market rent guidelines for the area where the Authority is located. If we found tenants who were no longer eligible for occupancy based on DHCD guidelines, we checked to find out if the applicable waivers were submitted to DHCD for its review as required by the regulations.

- To determine whether fixed assets on the balance sheet existed, were properly valued, and were owned by the Authority, we cross-checked assets with prior years' financial records, supporting documentation, physical evidence, and source documents such as invoices. To determine that new purchases were properly accounted for, we searched for new purchases and dispositions and evaluated whether these assets were accounted for in accordance with generally accepted accounting principles and the Accounting Manual. To determine whether non-capitalized inventory was adequately controlled to safeguard it from theft and loss, we observed and asked the auditee about the formal control process in place for inventory between $1,000 and $4,999, such as tagging, existence of an accurate and complete inventory ledger, annual physical inventory, and reconciliation to the inventory ledger.

- To determine whether the Authority was compliant with Chapter 30B of the General Laws and Chapter 149, Section 44, of the General Laws, we reviewed the Authority's procurement of goods and services. We checked to make sure that quotes or bids were obtained from a vendor. We asked the executive director if she used collective purchasing and, if not, why not. To determine whether contract administration was properly managed, we reviewed active contracts for proper execution and compliance with DHCD requirements for awarding contracts. We verified that payments matched contract terms; that contracts were executed when they were required to be; and that contracts were approved by the appropriate parties, such as the board and DHCD.

- To determine whether the Authority is providing safe and sanitary housing to its tenants in compliance with the State Sanitary Code (105 CMR 410), DHCD regulations (760 CMR 6.06), and its own mission statement, we performed site inspections of selected units to verify that housing units were in safe and sanitary condition in compliance with applicable regulations. We also asked the executive director for the date of the annual site inspections and confirmed that annual inspections matched the board minutes.

- To determine whether cash and investments were being managed in accordance with DHCD guidelines outlined in Section 16(B) of the Accounting Manual, we selected and reviewed bank statements for the Authority's three cash and investment accounts. We reviewed for timely reconciliations by someone independent of the cash-management process; intact and timely deposits of cash; timely follow-up and resolution of reconciling items, including outstanding checks; adequate insurance to cover cash in checking; transfer of excess cash to an investment account to maximize interest income; checks signed by at least two persons, at least one a board member; and physical safeguarding of cash to prevent theft and loss.

- To determine whether vacancies and offline units were effectively managed to minimize turnaround time for re-occupancy and potential loss of income, we selected and tested vacancy records to verify that the Authority complied with DHCD procedures for preparing and filling vacant housing units. We identified units that exceeded the turnaround time considered normal by DHCD (21 working days) and calculated the potential lost revenue from these prolonged vacancies. We obtained explanations from the executive director of why these vacancies were prolonged and assessed the reasonableness of the explanations. We determined whether any offline units existed and, if so, what plans were being implemented to prepare them for occupancy and minimize lost income. We confirmed that vacancy reports submitted to DHCD via HAFIS were in agreement with the Authority's internal vacancy ledger.

- To determine whether accounts receivable were accurate, complete, and collectible, we reviewed tenants' accounts receivable to verify that rents were paid on time, that any past-due balances were promptly followed up on, and that any uncollectible balances were written off in a timely manner. We verified that the balance on the balance sheet matched the detailed tenants' accounts receivable. We reviewed outstanding balances for old items. We reviewed the procedures in place for past-due rent collection.

- To determine whether payroll and benefits were accurate and complete, we tested a sample of payroll expenditures for accuracy and proper payments. We confirmed that total payroll paid matched the budgeted amounts and employee W-2 forms. We verified that rates matched appropriate source documents such as labor and industry rates. We recalculated and confirmed that taxes withheld were paid to the tax authorities. We verified recorded amounts with what was listed in the Authority's books. To determine that accrued compensated absences were accurate, complete, and properly recorded, we obtained the fee accountant's worksheets for the audit period. We recalculated the amounts for accuracy. We confirmed that amounts matched source documents such as pay records and leave documents. We reviewed the Authority's benefit policy for earned vacation and sick time. We reviewed the executive director's contract for vacation and sick time. We determined whether the accrued amounts were accurate and complete and recorded in the appropriate period (current versus long term). We verified that accrued amounts matched the Authority's financial statements.

- To determine whether administrative expenditures (including the executive director's salary, travel, and credit-card payments) were authorized, complete, accurate, allowable, and compliant with DHCD rules and regulations, we selected a sample of the Authority's expenditures and tested to determine whether expenditures were properly authorized, reasonable, allowable, applicable to the Authority's operations, and supported by appropriate documentation. We also tested to make sure that the amounts were posted to the appropriate accounts. We verified that amounts paid matched the amounts billed. We compared the executive director's salary to the budgeted amount authorized by the board. We confirmed that increases matched the applicable budget guidelines. We confirmed that the executive director's salary did not exceed the maximum salary and benefits amount allowed by DHCD. We verified that amounts had been recorded properly, taxes had been paid and withheld correctly, and W-2 forms were accurate.

- To determine whether any associations, corporations, or other private entities were involved in the Authority's financial or management activities, we asked the executive director if any affiliations with such entities existed. During our testing in other areas such as contract administration, expenditures, tenant selection, and budget review, we looked for evidence of any related-party transactions or activities.

- We obtained an understanding of the internal controls deemed to be significant within the context of our audit objectives through inquiries of knowledgeable employees; observations of activities; and review of policies, procedures, and board meeting minutes. With regard to the internal controls deemed to be significant within the context of the audit objectives, we assessed whether those controls had been properly designed and were operating as management expected. We performed procedures designed to obtain sufficient, appropriate evidence to support our assessment about the effectiveness of these internal controls.

Information system controls were not an integral part of the Authority's internal controls. Therefore, we did not consider it necessary to evaluate information system controls. When performing our audit, we relied on hardcopy source documents, which we tested for accuracy and completeness. Because of the relatively small size and varied characteristics of the sample populations, we applied a non-statistical approach whenever sampling was used. As a result, the results from our sample could not be projected to the population.

Based on our audit, we have concluded that, except for the issues addressed in the Detailed Audit Results and Findings section of this report, for the period October 1, 2010 through December 31, 2012, the Authority maintained adequate internal controls and complied with applicable laws, regulations, policies, procedures, and other guidance in the areas reviewed.

# DETAILED AUDIT RESULTS AND FINDINGS WITH AUDITEE'S RESPONSE

*Audit Findings*

**1. The Authority did not comply with the Department of Housing and Community Development's requirements and generally accepted accounting principles.**

Some purchases in the Authority's Extraordinary Maintenance Non-Capitalized account were not properly accounted for, in that they should have been capitalized but were expensed in error. In addition, the Authority could not provide us with any documentation (e.g., schedules or records of purchase) to substantiate the $56,749 balance in its Furniture, Equipment and Machinery—Dwellings control account and in the Fixed Assets section of its balance sheet.

**a. Roof replacements and a central air-conditioning system totaling $312,288 were not capitalized as required by generally accepted accounting principles.**

Expenditures totaling $312,288 for five roof replacements for buildings ($302,788) and a central air-conditioning system for the office and the community room ($9,500) were not capitalized, recorded as assets, and depreciated (expensed)[2] over the estimated useful life of the assets as required by generally accepted accounting principles (GAAP) and the Department of Housing and Community Development's (DHCD's) Accounting Manual for State-Aided Housing Programs (the Accounting Manual). Instead, these purchases were expensed in fiscal year 2010, resulting in a substantial decrease to net income and operating reserves. These purchases were incorrectly charged to the Extraordinary Maintenance Non-Capitalized account. The correct accounting treatment would have been to charge the roof replacements to the Betterments and Additions—Capitalized account and the central air-conditioning system to the Replacements of Equipment—Capitalized account and expense these costs over the estimated useful lives of the assets.

The major effect of this error is that the Authority's financial data were not recorded in accordance with GAAP; this caused the financial statements to be incorrectly stated, unreliable, and inconsistent. The impact on the Net Income (Loss) account and operating reserves is significant for the affected periods. Had the Authority's financial data been recorded in accordance with GAAP, using standard depreciation formulas, only $5,047 and $1,900 would have been charged to depreciation expense for these items in the year when $302,788 and

[2] Capitalization and depreciation are explained in detail in Appendix A.

$9,500, respectively, were actually charged to the Extraordinary Maintenance Non-Capitalized account, and the difference would be listed as an asset on the balance sheet (under Fixed Assets).

#### *Authoritative Guidance*

Section 16(B)(a) of the Accounting Manual describes the requirements for capitalizing non-expendable equipment, as follows:

> *All purchases of equipment which have an expected useful life of more than one year, and cost $5,000 (An Authority may choose a lower threshold) or more per unit, must be capitalized. Equipment purchased but not capitalized, not less than $1000, plus all stoves and refrigerators, must utilize a formal policy for inventory purposes.*

Following these requirements would also ensure compliance with GAAP.

#### *Reason for Lack of Capitalization*

The fee accountant told us that these items were not capitalized because of an oversight.

#### *Recommendations*

To ensure that the financial statements are accurately stated, the fee accountant should correct the Authority's financial records to include the fixed assets in question as required by proper accounting guidelines outlined in the Accounting Manual and by GAAP. The fee accountant should also prepare the appropriate adjusting entries for the related depreciation expense.

### b. There were no supporting details for $56,749 in the Furniture, Equipment and Machinery—Dwellings Control account.

The Authority could not provide supporting documentation for the $56,749 in the Furniture, Equipment and Machinery—Dwellings control account reported on the balance sheet during the audit period. As a result, financial reporting by the Authority, on the balance sheet for the Furniture, Equipment and Machinery—Dwellings control account, cannot be substantiated and therefore cannot be relied on.

According to the fee accountant, this amount has been carried forward since the Authority's financial records were converted to GAAP more than 10 years ago. This amount, in its classification as an asset on the balance sheet, attaches a value of $56,749 to items owned by the Authority. Typically when assets are acquired, cash is used to pay for them. This means that the Authority should have supporting documentation and related assets as backup for this amount.

No reliable list of assets or supporting documentation exists to substantiate this amount. The account on the general ledger, and on the balance sheet, is called a control account and is a summary of other sub-ledgers. It is essentially an account that holds information about subsidiary accounts. Appendix B includes an explanation of why the balance sheet is such an important financial statement and therefore must be accurate, complete, and reliable for stakeholders that rely on it, such as DHCD and the board.

The Furniture, Equipment and Machinery—Dwellings control account generally includes all equipment and fixtures (capitalized and non-capitalized) that are paid for from development/modernization funds or operating receipts for the original cost, restoration, or replacement of property located in the dwelling units. We saw no documentation that we could rely on to support the amount listed.

### *Authoritative Guidance*

Section 15(D) of the Accounting Manual describes the procedures for inventorying furniture and equipment:

> 1) *A physical inventory of all Furniture and Non-Expendable Equipment must be taken and an inventory list maintained each year.*
>
> 2) *Physical inventory results must be compared to equipment record and any differences and discrepancies will be reviewed by the [local housing authority] for possible adjustments.*

### *Reasons There Are No Supporting Details*

The fee accountant told us that the amount has been carried forward since the Authority's books were converted to GAAP about 10 years ago. It appears to us that the Authority has not performed a complete analysis of the balance to determine the source of the amount since that time.

### *Recommendations*

The Authority should perform an analysis of the Furniture, Equipment and Machinery—Dwellings control account to determine what the correct balance should be. It should also prepare an adjusting entry to record the correct amount based on the analysis performed and should ensure that there are verifiable supporting records for the total amount recorded in the Furniture, Equipment and Machinery—Dwellings control account. On an ongoing basis, at least annually, the Authority should perform an analysis of the balance in the account (e.g., by performing a physical inventory) and keep a physical record, if necessary. It is important to perform this analysis annually because financial records are typically audited on an annual basis by external accountants and the audited financial statements are prepared and reported to external parties. Because of this, most entities work to ensure that all adjustments and corrections are processed before the end of their fiscal year.

## 2. The Authority did not comply with state laws governing contracts for building-related work.

We tested a non-statistical judgmental sample of 6 out of 13 non-routine expenditures and found that the Authority did not prepare an invitation to bid or request for proposals for door replacements with an original price of $25,200 (greater than the $25,000 requiring written or oral quotes), nor did it advertise in the Central Register[3] as required by Chapter 149, Section 44, of the Massachusetts General Laws. As a result, the Authority cannot be sure that it paid the best price for this work.

That section of the General Laws sets forth specific, tiered bidding procedures based on the cost of a building-related project. For this door-replacement project, the Authority was required to advertise for sealed bids.

The Authority's manager is knowledgeable about the requirements of Chapter 149, Section 44, of the General Laws. Because its contracting process for the door replacements did not comply with Chapter 149's requirements governing contracts for the construction, reconstruction, installation, demolition, maintenance, or repair of any building involving labor and materials estimated to cost more than $25,000, the Authority cannot be sure that it received the best price.

### *Legal Requirements*

Chapter 149, Section 44A(2), of the General Laws states, in part,

> *(B) Every contract for the construction, reconstruction, installation, demolition, maintenance or repair of any building estimated to cost not less than $10,000 but not more than $25,000 shall be awarded to the responsible person offering to perform the contract at the lowest price. The public agency shall make public notification of the contract and shall seek written responses from persons who customarily perform such work. The public notification shall*

[3] The Central Register provides pertinent information about state, county, and municipal contracts that have been put out to bid for the design or construction of Massachusetts facilities.

*include a scope-of-work statement that defines the work to be performed and provides potential responders with sufficient information regarding the objectives and requirements of the public agency and the time period within which the work shall be completed. For the purposes of this paragraph, "public notification" shall include, but need not be limited to, posting at least 2 weeks before the time specified in the notification for the receipt of responses, the contract and scope-of- work statement on the website of the public agency, on the COMPASS system, in the central register published pursuant to section 20A of chapter 9 and in a conspicuous place in or near the primary office of the public agency.*

*(C) Every contract for the construction, reconstruction, installation, demolition, maintenance or repair of any building by a public agency estimated to cost not less than $25,000 but not more than $100,000, except for a pumping station to be constructed as an integral part of a sewer construction or water construction project bid under the provisions of section 39M of chapter 30, shall be awarded to the lowest responsible and eligible bidder on the basis of competitive bids publicly opened and read in accordance with the procedure set forth in said section 39M of said chapter 30. The term "pumping station" as used in this section shall mean a building or other structure which houses solely pumps and appurtenant electrical and plumbing fixtures.*

Further, Chapter 149, Section 44J(1), of the General Laws states,

> *No public agency or authority of the commonwealth or any political subdivision thereof shall award any contract for which competitive bids are required pursuant to section forty-four A of this chapter or section thirty-nine M of chapter thirty, or for which competitive proposals are required pursuant to subsection (4) of section forty-four E of this chapter or section eleven C of chapter twenty-five A, unless a notice inviting bids or proposals therefor shall have been posted no less than one week prior to the time specified in such notice for the receipt of said bids or proposals in a conspicuous place in or near the offices of the awarding authority, and shall have remained posted until the time so specified, and unless such notice shall also have been published at least once not less than two weeks prior to the time so specified in the central register published by the secretary of state pursuant to section twenty A of chapter nine and in a newspaper of general circulation in the locality of the proposed project. Said notice shall also be published at such other times and in such other newspapers or trade periodicals as the commissioner of capital asset management and maintenance may require, having regard to the locality of the work involved.*

#### *Reason for Noncompliance*

The executive director stated that the original quote for the door replacements was $24,900 and that they were therefore not put out to bid. However, Chapter 149 requires that a competitive procurement process be used for all contracts expected to cost $10,000 or more.

#### *Recommendations*

The Authority should ensure that every contract for construction, labor, and materials fully complies with the requirements detailed in Chapter 149, Sections 44A – 44J, of the General Laws.

### 3. The Authority did not obtain waivers from DHCD for two tenants' rents exceeding the fair market rents used to determine eligibility for continued occupancy according to DHCD regulations.

We tested a non-statistical, random sample of tenants' income eligibility for continued occupancy under 760 Code of Massachusetts Regulations (CMR) 5.06. Two of 12 tenants' rents we reviewed were not in compliance with the established guidelines for continued occupancy because their rents, calculated using 30% of their income, exceeded fair market rents (FMRs) established by the United States Department of Housing and Urban Development (HUD) for the region. However, the Authority did not submit waiver applications to DHCD, as required by law, requesting approval to set aside the income eligibility requirements of 760 CMR 5.06, nor did it serve the tenants with eviction notices.

The Authority has a tenant waiting list, and there may be people on the list who are in greater need, based on income, of the space currently occupied by the two noncompliant tenants.

#### *Legal Requirements*

The Revised Income Limits for Admission report and the Fair Market Rents for Continued Occupancy are guidelines established by HUD, which DHCD communicates to all housing authorities via a public housing notice.

The state-aided elderly/handicapped housing program, Chapter 667, provides housing for qualified low-income elderly and handicapped persons as defined in Chapter 121B of the General Laws. Applicants must meet certain income eligibility requirements for admission to state-aided public housing. Pursuant to 760 CMR 5.06, a local housing authority's (LHA's) income limits are set at two-year intervals and are equal to the low income limits set by HUD for a similarly sized household in the city or town in which the LHA is located. Income limits are set at 80% of the median income for the HUD-designated area in which the LHA is located. Tenants who live in Chapter 667 housing pay 30% of their income for rent. In addition to the Revised Income Limits for Admission report, there is an FMR report that the LHA must use to determine whether a tenant remains eligible for continued occupancy. According to 760 CMR 5.06(2),

> *A household occupying a unit in elderly/handicapped housing shall remain eligible for continued occupancy until such time as 30% of its monthly net household income equals or exceeds the fair market rent (FMR) then in effect for the Section 8 Existing/Voucher Program for a unit of appropriate unit size in the area in which the LHA is located.*

If the tenant is no longer eligible for occupancy and the LHA does not wish to evict the tenant, it can submit a waiver application to DHCD in accordance with 760 CMR 5.15, asking DHCD to give the LHA permission not to evict the tenant.

#### *Reasons for Not Obtaining Waivers*

The executive director stated that she did not request waivers for the two noncompliant tenants because the variances were insignificant and historically DHCD has allowed tenants to maintain their residency even when their rents exceeded the FMR by a small amount or for a limited amount of time.

#### *Recommendations*

If the Authority decides to request the waivers from DHCD, then it should submit its requests immediately. It should also work with the board to develop a contingency plan in case DHCD does not approve the waivers and the tenants need to be given eviction notices.

### 4. The Authority lacked adequate control over inventory of furniture and equipment.

During our audit period, the Authority had not developed and implemented a formal control policy over inventory as required by DHCD for proper internal controls.

#### a. The Authority had not documented an adequate capitalization policy.

The Authority had not documented an adequate capitalization policy for fixed assets as required by DHCD in the Accounting Manual. As a result, fixed assets might not be properly accounted for. This could cause a misstatement of fixed assets on the Authority's balance sheet, incorrect accumulation of financial data, and incorrect reporting of those data to DHCD and the Authority's board of commissioners.

#### *Authoritative Guidance*

The Accounting Manual is provided to LHAs to ensure that financial information is properly accumulated and reported in a timely and accurate manner. To that end, the Accounting Manual provides guidelines, templates, and suggestions for the authorities to follow.

Section 16 of the Accounting Manual provides a suggested format for a capitalization policy:

> *Inherent in a strong system of internal control are proper administrative controls to safeguard the assets of an LHA. Such administrative controls would include the adoption of policies to control the <u>inventory</u> of capital assets, the proper <u>investment</u> of funds, the <u>purchases</u> of equipment materials, supplies and services, and the <u>disposition</u> of capital assets.*

Although the Authority had a policy titled "Disposition and Capitalization Policy," this policy did not address some of the key requirements outlined in the suggested capitalization policy presented by DHCD in Section 16 of the Accounting Manual. For example, the policy did not establish a minimum dollar threshold at which all purchased equipment with a life of at least one year must be accounted for as a capital asset.

#### *Reasons There Was No Capitalization Policy*

The actual update did not appear to have been a priority, since the Authority believed that, in practice, it was implementing the current laws, rules, regulations, and DHCD guidelines applicable to LHAs. Also, the Authority had a document titled "Disposition and Capitalization Policy." However, as noted, it did not meet the standards outlined by DHCD in the Accounting Manual, which was updated July 1, 2004. The Authority's policies and procedures were last updated in January 2003, and even then, the Disposition and Capitalization Policy did not adequately reflect the requirements outlined in Section 16 of the Accounting Manual.

#### *Recommendations*

The Authority should develop and implement a comprehensive capitalization policy that models the guidelines in the suggested policy in Sections 16(A), 16(B), and 16(C) of the Accounting Manual.

### b. The Authority had no formal inventory control policy.

The Authority had not established a formal control policy to adequately control its inventory of capitalized and non-capitalized furniture, equipment, and machinery. As a result, we could not verify the completeness and accuracy of inventory or rely on the completeness and accuracy of the documentation provided to support non-capitalized inventory. Without a formal inventory control policy, fixed-asset balances might not be accurately stated on the Authority's balance sheet and non-capital inventory might not be adequately safeguarded against loss, theft, or misuse because the Authority cannot verify that the inventory is accurate and complete.

#### *Authoritative Guidance*

DHCD requires that a formal system for the inventory of furniture and equipment be established for every program an LHA runs. As stated in the Accounting Manual, the inventory should be divided into two separate parts: (1) a capital inventory (fixed assets) that will include all furniture and equipment costing $5,000 or more, which will be capitalized and depreciated over its estimated useful life, and (2) a non-capital/control inventory for all items expensed at purchase[4] and costing between $1,000 and $5,000, plus all stoves and refrigerators, regardless of price.

DHCD requires that LHAs establish the original cost (or fair market value) of all currently owned equipment purchased with DHCD funds. The LHA can determine its currently owned equipment, and its original cost or fair market value, by taking a physical inventory and researching past amounts charged to the operating reserve for purchases. This process would establish the content and value of the inventory, which would be the basis for an accounting entry.

#### *Reasons There Was No Formal Inventory Control Policy*

Management had not hired the temporary employees needed to perform the necessary work. The executive director told us that she needed someone to identify what the Authority had on hand in terms of inventory and put the information online.

#### *Recommendations*

The Authority should establish the existence and valuation of its non-capital inventory costing $1,000 and more to start the internal control process. Inventory records should be updated in a timely manner when a requisition or a disposition of an asset occurs, physical inventory should be taken at least annually, and inventory records should be adjusted to reflect the physical inventory amounts. All adjustments should be recorded on the Authority's books to ensure that the physical count matches the inventory records.

[4] "Expensed at purchase" refers to items that are not depreciated over their useful lives.

### 5. The Authority's policies, procedures, and management plan were outdated.

The Authority's policies, procedures, and management plan were last updated and approved by the board of commissioners in January 2003. As a result, employees might not be using the most up-to-date information to guide them in their work; this can result in inefficient operations and the allocation of more resources to a task than necessary. Promoting efficiency in operations is one of the management controls that LHAs seek to ensure.

Because these documents were last updated more than 10 years ago, there were differences between the written policies and procedures and the actual practices (e.g., the written list of board members and employees was outdated), and some procedures did not include the most up-to-date information published by DHCD (e.g., the Procurement Policy contained outdated information). The current board had not signed off on the management plan, and none of the board members who were on the board in January 2003 were serving on the board during the audit period.

#### *Authoritative Guidance*

As noted in DHCD's sample template of the management plan,

> *The LHA is required by the terms of the [contract for financial assistance] to have an approved management plan for each development. The Plan is the document that sets forth the administrative and programmatic structure of an LHA. The Plan outlines and defines the systems that encompass an LHA's operations. Each section of the Plan must address the policy, procedures, oversight/monitoring, and contain the board vote if necessary.*

The management plan contains an extensive list of policies, procedures, practices, and documents intended to explain the operational components of the LHA; how they function; who directs and carries them out; and why they are needed.

In addition, best practices include an annual review of policies and procedures to help ensure that these documents are kept current and are reviewed and approved by the board.

#### *Reasons for Outdated Policies and Procedures*

The update did not appear to have been a priority, since in practice the Authority was implementing the current laws, rules, regulations, and DHCD guidelines applicable to LHAs. It might not have been a priority because the executive director had been with the Authority for more than 19 years and the maintenance workers had been with the Authority for about 10.

### *Recommendations*

The Authority should immediately update its policies, procedures, and management plan as required by DHCD guidelines and should obtain board approval of those documents. It should also ensure that the documents are reviewed in a timely manner, at least annually, in accordance with sound business practices; updated if necessary; and approved by the board.

## 6. The contracts for the Authority's executive director and the fee accountant had expired.

We obtained and reviewed copies of the contracts for the executive director and the fee accountant and found that the fee accountant's contract had expired on September 30, 2011 and the executive director's contract had expired on January 11, 2012. Without current, signed contracts, the Authority cannot be certain that the obligations of the involved parties are clearly stated and agreed upon.

The executive director's contract is signed by the chairman of the board on behalf of the Authority and also reviewed and approved by DHCD. The fee accountant's contract is signed by the executive director and also presented to the board for approval. Both the executive director's contract and the fee accountant's contract are required documents per the Authority's policies and procedures. These documents also outline job descriptions, rates for the accountant, and benefits for the executive director.

### *Authoritative Guidance*

As stated in the Authority's policies and procedures (General Job Descriptions, Section 2, Executive Director), "A contract between the Hopedale Housing Authority and the Executive Director must exist and be kept in full force and effect." Section A of the Fiscal Policy and Procedures section of the same document states, "A Fee Accountant is employed by the Authority. A contract is required. . . ."

### *Reasons the Contracts Were Not Renewed*

The executive director stated that she was waiting for DHCD's new template for executive-director contracts before signing a new contract for her own position. Additionally, she had not yet decided whether she was going to renew the fee accountant's contract. (It should be noted that the template is not required in order to renew the contract.)

#### *Recommendations*

The board and the executive director should establish new contracts for the executive director and the fee accountant, if they still desire to retain these people, as required by the Authority's policies and procedures. These are important documents, as they provide job descriptions and list the legal obligations of the Authority and the person under contract.

### 7. Accounting for compensated absences was inaccurate and incomplete.

During our review of accrued compensated absences, we identified the following issues:

#### a. Accrued vacation time was overstated for fiscal years 2011 and 2012.

Accrued vacation time reported on the balance sheet for fiscal year 2011 was overstated by $933,[5] and accrued vacation time reported on the balance sheet for fiscal year 2012 was overstated by $1,467.[6] Because vacation time was recorded incorrectly, benefits owed to employees were reported incorrectly to DHCD and the board.

To verify the accuracy of the accrual amounts posted to the Authority's financial statements, we independently recalculated the amounts using the Authority's leave records, pay rates, and payroll records showing vacation time used. The above variances are based on our recalculations compared to the amounts shown in these financial records.

Vacation, sick, and other leave time is accumulated for each employee based on earned benefits or, in the executive director's case, contract requirements. Time used is deducted from the accumulated balances. The executive director keeps track of leave time and provides the information to the fee accountant, who calculates the year-end leave time accrual for every employee. Leave time such as personal days, holidays, and compensatory days is not accrued, and during the audit period, the fee accountant did not accrue vested sick time for Authority employees either. The accrual value is calculated by multiplying the hours accrued by the current rate paid to the employee plus related benefits. Benefits were also not accrued. Only leave time estimated to be used in the next fiscal year should be recorded as current liabilities; the remainder should be recorded as long-term liabilities.

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[5] This amount includes $658 for the executive director for four days of vacation time and $275 for the Authority's two maintenance workers for three days of vacation time.

[6] This amount includes $1,187 for the executive director for seven days of vacation time and $280 for the Authority's two maintenance workers for three days of vacation time.

**b. Sick time was not being accrued for the executive director or the two part-time maintenance workers.**

Vested sick time for Authority employees was not being accrued and recorded in accordance with Governmental Accounting Standards Board (GASB) Statement 16, which requires sick leave to be accrued as a liability to the extent that the employer is likely to compensate the employee for it on termination or retirement. The Authority's policies and procedures and the executive director's contract stipulate that upon retirement, 20% of the value of an employee's accrued sick time will be paid to the employee. The executive director had accumulated 221 days of sick leave at the end of fiscal year 2012; 20% of that leave represents $7,494 for fiscal year 2012. That amount should be recorded in the Authority's financial statements as a long-term liability. In addition, at the end of fiscal year 2012, the two maintenance workers had accumulated 160 days of sick leave, 20% of which represents $2,993. That amount should also be recorded in the Authority's financial statements as a long-term liability. The total value of the three employees' accrued sick time was $10,487. Incorrectly recorded sick time totals may deny employees a cash benefit to which they are entitled upon retirement.

**c. The board of commissioners did not approve accrued vacation time that exceeded the maximum allowed.**

The executive director accrued more vacation time than permitted by her contract without approval from the board of commissioners. As a result, the executive director may have received unallowable vacation time.

According to the executive director's contract, "The Executive Director shall not accrue more than 40 days of vacation leave without specific approval of the Board. . . ." At the end of fiscal year 2011, the executive director had accumulated 50 days of vacation time. At the end of fiscal year 2012, the executive director had accumulated 47 days of vacation time. We requested copies of the board approvals for these overages and found that the board had not approved them. The executive director requested approval from the board when we brought this to her attention.

### *Authoritative Guidance*

According to the executive director's contract,

> *Compensation shall be made to her for sick leave accrued for her account in the event of separation or termination of employment for any cause. . . . Upon retirement, the Executive*

> *Director shall be entitled to 20% of unused sick leave at her regularly established rate of compensation. . . .*

In addition, the Authority's sick leave policy states, in part,

> *Upon termination of employment, no payment is made for unused sick leave, except in the case of termination due to retirement, in which case payment is made for twenty (20) percent of any unused sick leave.*

GASB 16 provides the following guidelines:

> *This Statement provides guidance for the measurement of accrued compensated absences liabilities by state and local governmental entities, regardless of the reporting model or fund type used to report the transactions. Compensated absences are absences for which employees will be paid, such as vacation, sick leave, and sabbatical leave.*
>
> *The standards in this Statement give consideration to the different characteristics of various types of compensated absences. For example, employees usually receive full compensation for vacation leave—either as paid time off or as compensation at termination or retirement. Thus, employees earn the right to be compensated for vacation leave based only on rendering past service. On the other hand, paid time off for earned sick leave is contingent on an illness—a specific event that is outside the control of the employer and employee. In some cases, however, employees may be compensated for a portion of their sick leave when they terminate or retire. In those cases, employees earn the right to be compensated for sick leave at termination based only on rendering past service.*
>
> *Vacation leave and other compensated absences with similar characteristics should be accrued as a liability as the benefits are earned by the employees if the leave is attributable to past service and it is probable that the employer will compensate the employees for the benefits through paid time off or some other means, such as cash payments at termination or retirement.*
>
> *Sick leave and other compensated absences with similar characteristics should be accrued as a liability as the benefits are earned by the employees but only to the extent it is probable that the employer will compensate the employees for the benefits through cash payments conditioned on the employees' termination or retirement ("termination payments"). Alternatively, the liability should be measured based on the sick leave and other compensated absences with similar characteristics accumulated at the balance sheet date by those employees who currently are eligible to receive termination payments as well as other employees who are expected to become eligible in the future to receive such payments. When the liability is calculated, these accumulations should be reduced to the maximum amount allowed as a termination payment.*
>
> *This Statement requires the compensated absences liability generally to be measured using the pay or salary rates in effect at the balance sheet date. It also requires additional amounts to be accrued for certain salary-related payments associated with the payment of compensated absences, for example, the employer's share of social security and medicare taxes.*

### *Reasons Compensated Absences Were Not Properly Accounted For*

The fee accountant did not completely understand GASB 16 requirements, contract requirements, and the requirements of the Authority's policies and procedures.

### *Recommendations*

The fee accountant should make the necessary adjustments to correct the vacation accrual and record the vested sick time accrual. In the future, the Authority should consider reviewing the final accrual number before recording to ensure that the information recorded is accurate, complete, and in compliance with the contract agreement and the Authority's policies and procedures. It should also ensure that the accruals are properly split between current and long-term liabilities on the balance sheet to accurately reflect proper classification of the amounts.

### *Auditee's Response*

The Authority's executive director made the following comments in response to the issues raised in this report:

> *I, along with Hopedale's Fee Accountant . . . have made the necessary adjustments to correct the sick and vacation accrual. The inventory has been updated using the $1,000.00 threshold which was voted to increase from $300.00 to $1,000.00 by the Authority's Board. The Board also voted to approve the Director's accrued vacation time over the maximum allowed. [The fee accountant] has also corrected all of what he was asked to do.*
>
> *The Director is working on updating the policies and procedures, the inventory, working on a calendar for attendance. I explained the reason for the . . . door replacements going over the $25,000.00 and not receiving the tenant rent waivers, which in the future I will request written waivers from DHCD, it is always my goal to comply with state laws governing contracts for bid proposals.*

### *Auditor's Reply*

The Authority's response indicates that it has taken measures to address many of the concerns raised in this report. In addition to the measures already taken, the Authority should ensure that its policies, procedures, and management plan are reviewed at least annually, in accordance with sound business practices; updated if necessary; and approved by the board. It should also establish new contracts for its executive director and fee accountant.

# APPENDIX A

## CAPITALIZATION AND DEPRECIATION

"Capital assets" and "fixed assets" are accounting terms used to describe items such as land, buildings and building improvements, furniture, equipment, and machinery that have an estimated useful life of more than one year (the usual accounting period) and cost $5,000 or more per unit, although a local housing authority may choose a lower threshold. The Hopedale Housing Authority's capitalization policy must establish a minimum dollar value at which all purchased items must be capitalized. An estimated useful life of more than one year simply means that the item provides value for more than one year. The item is used, benefited from, and accounted for over its estimated useful life. This process is known as depreciation. Different items are assigned different useful lives. For example, a building could have a life of 40 years; a truck, 5 years; a roof replacement, 15 years; an air-conditioning system, 5 years. Capital assets are recorded in the Assets section on the balance sheet. The Accumulated Depreciation account, which reduces the recorded value of the asset by the amount depreciated over time, is also included on the balance sheet with the fixed assets.

# APPENDIX B

## THE BALANCE SHEET

The balance sheet is one of three key financial statements. It shows what an entity owns (assets); what the entity owes (liabilities); and net assets, the difference after liabilities have been deducted from assets. The relationships among assets, liabilities, and net assets, known as the accounting equation, are the backbone of the accounting and reporting system. The accounting equation is central to the understanding of the balance sheet, which is a snapshot of what an entity looks like financially at a moment in time

If the information presented on the financial statements, including the balance sheet, is not accurate and complete, then stakeholders such as taxpayers, the Department of Housing and Community Development, the board of commissioners, and the Legislature will not be able to rely on the information reported and will not be able to assess and make decisions about the performance of the entity under review.

Assets are the economic resources of the entity and include cash, investments, accounts receivable, inventories, property, and equipment. Assets can be further classified as current (those that can be converted to cash in one year or less) or long term (those that will be converted to cash in a period longer than one year). An important measure of accounting performance is the current ratio, which compares current assets to current liabilities to show the liquidity of the entity. The higher the ratio, the better the entity's position and ability to pay its obligations.

Liabilities are amounts owed to others by the entity that relate to loans, extensions of credit, and other obligations arising in the course of doing business. Liabilities, like assets, can be classified as current or long term and can be used in performance analysis as described above.

Net assets are the owner's interest in the business, the amount that remains after liabilities have been deducted. The categories in the Net Assets section of a housing authority's balance sheet include Net Income/Loss; Investment in Capital Assets, Net of Related Debt, Net Assets—Restricted, and Net Assets—Unrestricted.