Commonwealth of Massachusetts
Office of the State Auditor
Suzanne M. Bump

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Official Audit Report – Issued February 2, 2012

Shrewsbury Housing Authority

For the period January 1, 2008 through August 31, 2010

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The Shrewsbury Housing Authority is authorized by and operates under the provisions of Chapter 121B of the Massachusetts General Laws. The Authority oversees 272 public housing units, 136 state elderly units, 17 family units, 15 special needs housing units, 100 federal elderly units, and 173 subsidized program vouchers. The Authority was awarded an American Recovery and Reinvestment Act (ARRA) grant from the Department of Housing and Urban Development (HUD) for capital improvements in the amount of $135,500 to purchase new appliances and equipment, install heat in a maintenance garage, and replace windows. As of August 31, 2010, the Authority had expended the full amount of the grant.

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted an audit of certain activities of the Authority for the period January 1, 2008 through June 30, 2010. Our audit was expanded to cover activities related to the Authority's ARRA award of $135,500 for the period March 18, 2009 through August 31, 2010. The objectives of our audit were to review and analyze management controls and practices over the following areas and functions listed for the purpose of determining their adequacy and review compliance with laws, rules, and regulations: 1) tenant selection; 2) preparing and filling vacant units; 3) rent determinations; 4) collectability of accounts receivables; 5) site inspections; 6) payroll, travel, and fringe benefits; 7) disbursements; 8) inventory controls over property and equipment; 9) contract procurement; 10) cash management and investment practices; 11) comparing DHCD approved budgets to actual expenditures; 12) verifying the level of need for operating subsidies and for operating reserves; and 13) the administration of development funds to determine, among other items, the existence of excess funds. Also, we conducted a review of federal stimulus funds received and expended by the Authority and evaluated compliance with laws, rules, and regulations applicable to ARRA.

Based on our review, we have concluded that, except for the issues addressed in the Audit Results section of this report, for the period January 1, 2008 through June 30, 2010 for state funds, and the period March 18, 2009 through August 31, 2010 for ARRA funds, the Authority maintained adequate management controls and complied with applicable laws, rules, and regulations for the areas tested.

Our review of the ARRA grant expenditures found that the Authority did not comply with the prevailing wage requirements of the ARRA grant, which include the federal Davis-Bacon Act and provisions of the Massachusetts Prevailing Wage Law, Chapter 149, Sections 26 and 27, of the Massachusetts General Laws. The Executive Director stated that he did not require that prevailing wages be paid nor did he have documentation from the contractors indicating they paid prevailing wages to their employees.

Our review of ARRA expenditures found that the Authority drew down funds to reimburse applicable management expenses. In accordance with HUD's instructions, the Authority drew down $13,500 as a management fee, equivalent to 10% of the ARRA grant. We requested documentation for the administrative costs associated with the $13,500 management fee; however, the documentation provided did not specify the administrative expenses that were reimbursed. The Authority's Fee Accountant provided journal entries prepared by the prior accountant that reallocated the management fee to administrative and maintenance salary accounts; however, there was no documentation accompanying the entries to explain how salaries were allocated as well as what those specific costs represent.

The Authority has experienced a steady decline in its net asset unrestricted account (formerly the operating reserves) over the last three years, leaving the Authority's net asset unrestricted account with a $12,688 negative balance as of March 31, 2010. We found that the Authority sustained net losses of more than $100,000 in each of the last three fiscal years.

Our review of the Authority's payroll records disclosed that the Authority was incorrectly withholding Medicare taxes from its Maintenance Supervisor's salary. The Maintenance Supervisor was hired on October 15, 1973 and, in accordance with the Internal Revenue Service regulations, was not subject to Medicare tax withholdings. We determined that, during the audit period, Medicare taxes totaling $2,075 were incorrectly withheld.

INTRODUCTION

Background

The Shrewsbury Housing Authority is authorized by and operates under the provisions of Chapter 121B of the Massachusetts General Laws. The Authority oversees 272 public housing units, 136 state elderly units, 17 family units, 15 special needs housing units, 100 federal elderly units, and 173 subsidized program vouchers.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, the Office of the State Auditor has conducted an audit of certain activities of the Authority for the period January 1, 2008 through June 30, 2010. Our audit was expanded to cover activities related to the Authority's American Recovery and Reinvestment Act (ARRA) award of $135,500 for the period March 18, 2009 through August 31, 2010. The objectives of our audit were to review and analyze management controls and practices over the following areas and functions listed for the purpose of determining their adequacy and review compliance with laws, rules, and regulations: 1) tenant selection; 2) preparing and reoccupation of vacant units; 3) rent determinations; 4) collectability of accounts receivables; 5) site inspections; 6) payroll, travel, and fringe benefits; 7) disbursements; 8) inventory controls over property and equipment; 9) contract procurement; 10) cash management and investment practices; 11) Department of Housing and Community Development (DHCD) – approved budgets versus actual expenditures; 12) level of need for operating subsidies and operating reserves; and 13) the administration of development funds to determine, among other items, the existence of excess funds. In addition, we conducted a review of federal stimulus funds received and expended by the Authority and evaluated compliance with laws, rules, and regulations applicable to ARRA.

During our audit period, the Authority was awarded an ARRA grant from the Department of Housing and Urban Development (HUD) for capital improvements in the amount of $135,500 to purchase new appliances and equipment, install heat in a maintenance garage, and replace windows. As of August 31, 2010, the Authority had expended the full amount of the grant. The following table details the federal stimulus funds awarded, received, and expended during the audit period:

Program/Purpose	Amount of Award	Amount Received	Amount Expended
Capital Fund Formula Grant:			
Appliances	$ 86,625	$ 86,625	$ 86,625
Trash Compactor	14,300	14,300	14,300
Management Fee	13,500	13,500	13,500
Window Replacement	11,075	11,075	11,075
Heating System	10,000	10,000	10,000
Total	$135,500	$135,500	$135,500

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. To achieve our audit objectives, we reviewed the following:

- Tenant-selection procedures to verify that tenants were selected in accordance with DHCD regulations;
- Vacancy records to determine whether the Authority adhered to DHCD procedures for preparing and filling vacant housing units;
- Annual rent-determination procedures to verify that rents were calculated properly and in accordance with DHCD regulations;
- Accounts receivable procedures to ensure that rent collections were timely and that uncollectible tenant accounts receivable balances were written off properly;
- Site-inspection procedures and records to verify compliance with DHCD inspection requirements and that selected housing units were in safe and sanitary condition and to determine whether the Authority has in place an updated official written property maintenance plan for its managed properties;
- Procedures for making payments to employees for payroll, travel, and fringe benefits to verify compliance with established rules and regulations;
- Authority expenditures to determine whether they were reasonable, allowable, and applicable to the Authority's operations and were adequately documented and properly authorized in accordance with established criteria;
- Property and equipment inventory-control procedures to determine whether the Authority properly protected and maintained its resources in compliance with DHCD regulations;

- Contract procurement procedures and records to verify compliance with public bidding laws and DHCD requirements for awarding contracts;

- Cash management and investment policies and practices to verify that the Authority maximized its interest income and that its deposits were fully insured;

- DHCD-approved operating budgets for the fiscal year in comparison with actual expenditures to determine whether line-item and total amounts by housing program were within budgetary limits and whether required fiscal reports were submitted to DHCD in a complete, accurate, and timely manner;

- Operating reserve accounts to verify that the Authority's reserves fell within DHCD provisions for maximum and minimum allowable amounts and to verify the level of need for operating subsidies to determine whether the amount earned was consistent with the amount received from DHCD;

- Development awards to verify that contracts were awarded properly and that funds were received and disbursed in accordance with the contracts, and to determine the existence of any excess funds; and

- ARRA funding procedures to determine whether the Authority's transactions relating to ARRA funding were allowable per terms of the grant, including whether funds were properly received, disbursed, and reported.

Based on our review, we have concluded that, except for the issues addressed in the Audit Results section of this report, for the period January 1, 2008 through June 30, 2010 for state funds, and the period March 18, 2009 through August 31, 2010 for ARRA funds, the Authority maintained adequate management controls and complied with applicable laws, rules, and regulations for the areas tested.

AUDIT RESULTS

1. FAILURE TO REQUIRE OR DOCUMENT COMPLIANCE WITH THE PREVAILING WAGE REQUIREMENTS OF THE ARRA GRANT

Our review of the American Recovery and Reinvestment Act (ARRA) grant expenditures found that the Authority paid two window contractors a total of $15,193 and a plumbing company $10,997 using ARRA and other federal funds. However, the Authority failed to comply with the prevailing wage requirements of the ARRA grant, which include the Federal Davis-Bacon Act (DBA) and provisions of the Massachusetts Prevailing Wage Law (MPWL), Chapter 149, Sections 26 and 27, of the Massachusetts General Laws.

The DBA requires that all contractors and subcontractors employed under federal contracts in excess of $2,000 pay their laborers and mechanics not less than the prevailing wage rates and fringe benefits listed in the contract's DBA wage determination for corresponding classes of laborers and mechanics employed on similar projects in the area. Section 1606 of the ARRA provides that employees "shall be paid wages at rates not less than those prevailing on projects of a character similar in the locality as determined by the Secretary of Labor in accordance with subchapter IV of chapter 31 of title 40, United States Code." This section refers to the federal DBA, which establishes minimum wages to be paid to employees in certain trades on certain federal projects. The Massachusetts Executive Office of Labor and Workforce Development memorandum entitled "Notice to Awarding Authorities for Projects Funded through the American Recovery and Reinvestment Act," dated March 2009, states, in part:

> *Persons awarding contracts for public works construction projects that are funded in whole or in part by the ARRA must comply with the provisions of both the DBA and the Massachusetts Prevailing Wage Law. Awarding authorities must obtain prevailing wage rate schedules from the Division of Occupational Safety and from the US Department of Labor, and must incorporate both sets of wage rates in the contract and require that the higher of the two rates be paid for each trade.*

Contracting agencies are required to include in all bid solicitations, and the resulting contracts, language that requires the payment of prevailing wages. The United States Department of Labor, Memorandum No. 207, dated May 29, 2009, regarding the applicability of Davis-Bacon labor standards to federal and federally assisted construction work funded in whole or in part under the provisions of ARRA, states, in part:

Regulations in 29 Code of Federal Regulations (CFR) 5.5 instruct agencies concerning application of the standard Davis-Bacon contract clauses set forth in that section. Federal contracting/assisting agencies must include the standard Davis-Bacon contract clauses found in 29 CFR 5.5 (a) in bid solicitations and resultant covered construction contracts that are in excess of $2,000 for construction, alteration or repair (including painting and decorating), regardless of the amount of ARRA funding or assistance.

Moreover, Chapter 149, Section 27, of the General Laws, states, in part:

In advertising or calling for bids for said works, the awarding official or public body shall incorporate said schedule (rate or rates of wages) in the advertisement or call for bids by an appropriate reference thereto, and shall furnish a copy of said schedule, without cost, to any person requesting the same. Said schedule shall be made a part of the contract for said works and shall continue to be the minimum rate or rates of wages for said employees during the life of the contract.

We found the Authority solicited quotes from the window contractors and the plumbing contractor; however, it did not require that the vendors comply with the prevailing wage requirements.

The Executive Director stated that he did not require that prevailing wages be paid nor did he have any documentation from the contractors indicating they paid prevailing wages to their employees. Without properly notifying vendors that prevailing wages are required to be paid, the Authority cannot be assured that all employees who worked on the federal ARRA grant were paid the proper wages.

Recommendation

The Authority should discuss the issue of failing to comply with the DBA and MPWL with the source of funding for the project, the Department of Housing and Urban Development (HUD), to determine what action should be taken. In the future, should the Authority receive additional ARRA funds, it should ensure that all wage requirements are followed.

Auditee's Response

We managed the ARRA grant following directions from HUD.

Auditor's Reply

We cannot verify the Authority's assertion that it was "following directions from HUD" concerning the payment of prevailing wages because the Authority did not provide us with evidence of such instruction. As stated in the report, the Authority did not require that prevailing wages be paid nor did it have any documentation from the contractors indicating that prevailing wages were paid.

2. IMPROVEMENTS NEEDED IN DOCUMENTING ARRA EXPENDITURES

Our review of ARRA expenditures found that the Authority drew down funds to reimburse applicable management expenses. In accordance with HUD's instructions, the Authority drew down $13,500 as a management fee, equivalent to 10% of the ARRA grant; however, from the documentation provided to us, we were unable to determine what specific administrative expenses the ARRA funds were used to reimburse.

HUD Notice, "Information and Procedures for Processing American Recovery and Reinvestment Act Capital Fund Formula Grants," states that "all expenditures from Account 1410 (Administration) are limited to 10% of the total grant. A Public Housing Agency (PHA) may draw up to 10% of each expenditure reimbursement for administration of the Recovery Act grant." Frequently Asked ARRA Question No. 20 discusses the need for backup documentation for the 10% draw down of ARRA funds for administrative costs. The answer to the question states:

> *It is correct that a PHA [Public Housing Authority] is permitted to automatically take 10 percent for administrative costs for each drawdown. And these funds can be paid to the Central Office Cost Center (COCC) for administrative costs/as a management fee. However, OMB [Office of Management and Budget] has not yet provided final guidance on Transparency and Reporting Requirements. Since PHAs must comply with all Recovery Act requirements, they should maintain sufficient documentation to demonstrate specifically what Recovery Act funds were used for within the Capital Fund Program.*

The Authority has not established a COCC for administrative costs. HUD's Financial Handbook defines administrative costs as:

> *Administrative costs (Account 1410) that are necessary for the planning, design, implementation and monitoring of the physical and management improvements are eligible costs and include the following: A. Salaries. The salaries of non-technical and technical HA (Housing Authority) personnel assigned full-time or part-time to modernization are eligible costs only where the scope and volume of the work are beyond that which could be reasonably expected to be accomplished by such personnel in the performance of their non-modernization duties. The HA shall properly apportion to the appropriate program budget any direct charges for the salaries of assigned full- or part-time modernization. The HA may allocate salary expense through use of the time sheet method, as set forth in OMB Circular A-87, or through use of a per unit or other reasonable basis, as set forth in the Financial Management Handbook 7475.1, as revised.*

> *The allocation method shall reflect a fair distribution between all programs administered by the HA for which there is a cost implication. The cost allocation methodology is subject to HUD review and approval. Any direct charges to the CGP (Capital Grant Program) for salaries shall result in an appropriate revision to the HA's operating budget.*

The Executive Director did not provide us with documentation for the administrative costs associated with the $13,500 management fee. He indicated that the former Fee Accountant for the Authority would have maintained the documentation for those expenditures and that the present Fee Accountant provided journal entries that reallocated the management fee to administrative and maintenance salary accounts; however, there was no documentation with the entries to explain how those salary allocations were arrived at or what specific costs they represent. Without an explanation and proper documentation for those costs, we cannot determine that those costs were ARRA-related.

Recommendation

The Authority should review this issue with HUD to determine whether the management fee and all ARRA expenditures were appropriate.

Auditee's Response

> *We managed the ARRA grant following directions from HUD.*

Auditor's Reply

We cannot verify the Authority's assertion that it was "following directions from HUD" concerning the use and documentation of the management fee because the Authority did not provide us with evidence of such instruction. As stated in the report, the Authority drew down the management fee; however, we could not determine what ARRA costs were associated with the management fee.

3. NEGATIVE OPERATING RESERVES

The Authority has experienced a steady decline in its unrestricted net asset account (formerly known as the operating reserves) over the last three years, leaving the Authority's unrestricted net asset account with a $12,688 negative balance as of March 31, 2010. We found that the Authority sustained net losses of more than $100,000 in each of the last three fiscal years. As a result, the Authority may not have the financial resources necessary to fund emergency situations or non-routine expenditures as they arise.

The Authority's unrestricted net asset account has declined as follows:

Date	Balance
March 31, 2007	$313,610
March 31, 2008	$205,913
March 31, 2009	$100,573
March 31, 2010	($12,688)

Prudent business practices advocate that the Authority have sufficient reserves to pay for any unforeseen expenses. Moreover, the Department of Housing and Community Development's (DHCD) Accounting Manual, Section 14, states, in part:

> *DHCD believes the one true indicator of the financial status of a management program is a correctly calculated operating reserve. Operating reserve is not just the combination of unrestricted and restricted net assets but is calculated by adding certain GAAP expenditures to the total of these two balances. . . . The purpose of the operating reserve is threefold. First, the operating reserve allows LHAs to have funds necessary for cash flows. Some months more cash is paid out than is received and it is therefore necessary to have additional cash to meet these needs. Second, LHAs must have reserve funds to meet emergency situations such as major boiler or roof repairs that have not been anticipated in the budget. Third, the operating reserve is used to fund non-routine expenditures such as the replacement of refrigerators and ranges. DHCD has established full and minimum balances for operating reserves that act as benchmarks for LHAs to assess the relative value of their operating reserve balances. The problem in evaluating the operating reserve has always been the question of what is the true balance. The operating reserve actual balance is always some balance either positive or negative, but the true operating reserve balance requires an analysis of the balance sheet and an understanding of how balance sheet items affect operating reserve.*

DHCD measures the unrestricted net asset balance based on the maximum and minimum amount balances at the close of each fiscal year. The maximum amount is based on 50% of the fiscal year budgeted expenditures and the minimum is 40% of the maximum amount.

While the Authority exceeded its minimum reserve levels for fiscal year 2008, during fiscal years 2009 and 2010, the Authority's unrestricted net asset account continued to decrease below DHCD's recommended minimum levels, as outlined in the following chart:

	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010
Maximum Reserve Levels	$314,046	$345,441	$358,598
Minimum Reserve Levels	$125,618	$138,176	$143,439
Net Asset Balance Year End	$205,913	$100,573	($12,688)
Percentage of Maximum	65.57 %	29.11%	(3.54%)

The chart below identifies the budgeting practices of the Authority as a contributing factor in the reduction in the unrestricted net asset account. We found that the Authority had projected a loss each year; however, during fiscal years 2008 and 2010, the Authority exceeded the projected loss by more than 100%. In fiscal year 2009, while it did not exceed the budgeted projected loss of $135,281, the Authority's unrestricted net asset account continued to decline below the minimum levels suggested by DHCD.

Fiscal Year	Budgeted Net Loss	Actual Net Loss	Difference
2008	$52,091	$107,697	$55,606
2009	$135,281	$105,340	($29,941)
2010	$55,196	$113,261	$58,065

There are many factors that contributed to the actual net loss. Each year, as part of the budget process, DHCD establishes an annual non-utility expenditure level (ANUEL) for each Authority. The budgeted ANUEL amount is the expenditure amounts in the administrative, maintenance, and general budgetary categories. In fiscal years 2008 through 2010, the Authority exceeded its adjusted budgeted ANUEL amount by $62,696, $34,785, and $16,341, respectively. In fiscal years 2008 and 2010, the Authority also exceeded its utility budget. In fiscal year 2009, the Authority purchased equipment totaling $48,773, which was budgeted for and in the Authority's actual net loss calculation; however, we found the Authority did not include the cost of the equipment on its 2009 operating statements.

We discussed the issue with Authority officials, who stated that they did not receive information from their outside accountant that reflected the problems with the unrestricted net asset account. They also stated that many of the extraordinary and maintenance costs during that period such as sidewalk and electrical repairs addressed safety concerns at the Authority's complexes.

Without the proper monitoring of the budget by the Board of Directors and the Executive Director, the Authority may not be able to address emergency situations arising in the future.

Recommendation

The Authority should review its future budgets to determine whether adjustments can be made that will increase the Authority's reserves to ensure that it has adequate reserve funds available for any unforeseen occurrences. The Board of Directors and the Executive Director must take an active role in monitoring and providing oversight for Authority operations. The OSA has sent a copy of this report to DHCD officials requesting they review their policies regarding housing authorities with inadequate reserve levels and evaluate the causes of this growing problem.

Auditee's Response

> *Our former Fee Accountant misstated our operating reserves. The Shrewsbury Housing Authority has retained a new Fee Accounting firm.*

Auditor's Reply

The Authority should review and manage its budget monthly with the new Fee Accounting firm to ensure that it does not sustain losses that will further impact its operating reserves.

4. EMPLOYEE MEDICARE TAXES WITHHELD INCORRECTLY

Our review of the Authority's payroll records disclosed that the Authority was incorrectly withholding Medicare taxes from its Maintenance Supervisor's salary. The Maintenance Supervisor was hired on October 15, 1973 and, in accordance with the Internal Revenue Service (IRS) regulations, was not subject to having Medicare taxes withheld from his pay. We determined that during our audit period, Medicare taxes totaling $2,075 were incorrectly withheld from the employee and the Authority incorrectly paid the matching portion of the tax.

In 2002, the Authority hired a payroll company to process its weekly payroll. The Maintenance Supervisor's date of hire was entered incorrectly and the payroll company deducted Medicare taxes from his paycheck. Because he started and continued his employment with the Authority and is a member of a public retirement system since 1973, he and the Authority were exempt from having to pay Medicare taxes. IRS Publication 963, Continuing Employment Exception, states:

> *Services performed after March 31, 1986, by an employee who was hired by a state or political subdivision employer before April 1, 1986, are exempt from mandatory Medicare tax if the employee is a member of a public retirement system and meets all of the following requirements: The employee was performing regular and substantial services for remuneration for the state or political subdivision employer before April 1, 1986; The employee was a bona fide employee of that employer on March 31, 1986; The employment relationship with that employer was not entered into for purposes of avoiding the Medicare taxes; and, The employment relationship with that employer has been continuous since March 31, 1986.*

The Maintenance Supervisor met each of these conditions and should have been exempt from Medicare tax deductions. The Executive Director informed us that he has contacted the payroll company, his legal counsel, and the Fee Accountant to resolve the issue.

Recommendation

The Authority should no longer withhold Medicare taxes from the Maintenance Supervisor's salary, determine the amount that was withheld, and file for a reimbursement of the taxes paid on behalf of the employee and the matching portion paid by the Authority. Once reimbursement is received, the Authority should reimburse the Maintenance Supervisor for the overpayment of the taxes.

Auditee's Response

> *An incorrect amount of Medicare was withheld from one employee paycheck; once the error was pointed out, it was corrected [and] the employee was reimbursed the full amount.*