



Office of the Washington State Auditor
Pat McCarthy

Accountability Audit Report
Kitsap County Consolidated Housing
Authority
(Housing Kitsap)

For the period July 1, 2016 through June 30, 2017

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**Office of the Washington State Auditor
Pat McCarthy**

August 6, 2018

Board of Commissioners
Housing Kitsap
Silverdale, Washington

Report on Accountability

Thank you for the opportunity to work with you to promote accountability, integrity and openness in government. The State Auditor's Office takes seriously our role of providing state and local governments with assurance and accountability as the independent auditor of public accounts. In this way, we strive to help government work better, cost less, deliver higher value and earn greater public trust.

Independent audits provide essential accountability and transparency for Housing Authority operations. This information is valuable to management, the governing body and public stakeholders when assessing the government's stewardship of public resources.

The attached comprises our independent audit report on the Housing Authority's compliance with applicable requirements and safeguarding of public resources for the areas we examined. We appreciate the opportunity to work with your staff and we value your cooperation during the audit.

Sincerely,

Pat McCarthy
State Auditor
Olympia, WA

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AUDIT RESULTS

This report describes the overall results and conclusions for the areas we examined. In most of the areas we examined, except as described below, Housing Authority operations complied with applicable state laws, regulations, and its own policies, and provided adequate controls over safeguarding of public resources.

As referenced above and described in the attached findings, we identified areas in which the Housing Authority could make improvements.

We recommended:

- The Housing Authority establish a formal financial plan to address its cash flow issues and sustainability. Management and the Board of Commissioners should closely monitor and evaluate the Housing Authority's financial activities to ensure the plan is being followed, the desired results are achieved, and the plan is revised as needed to resolve the Housing Authority's cash flow issues.
- The Housing Authority take the necessary steps to resolve the errors and issues related to its software conversion. Additionally, when implementing new software, the Housing Authority should ensure software has been properly evaluated, will meet the Housing Authority's needs and will allow for validation and testing of data to ensure financial, tenant and other data is accurate and complete. This includes retaining documentation supporting the validation process and a crosswalk of accounts between the two systems.

These recommendations were included with our report as findings.

As referenced above, we also noted certain matters that we communicated to Housing Authority management and Board of Commissioners in a letter dated July 26, 2018, related to cash receipting of tenant rents and timeliness of deposits. We appreciate the Housing Authority's commitment to resolving those matters.

About the audit

This report contains the results of our independent accountability audit of Housing Kitsap from July 1, 2016 through June 30, 2017.

Management is responsible for ensuring compliance and adequate safeguarding of public resources from fraud, loss or abuse. This includes the design, implementation and maintenance of internal controls relevant to these objectives.

This audit was conducted under the authority of RCW 43.09.260, which requires the Office of the State Auditor to examine the financial affairs of all local governments. Our audit involved

performing procedures to obtain evidence about the Housing Authority's uses of public resources, compliance with state laws and regulations and its own policies and procedures, and internal controls over such matters.

In keeping with general auditing practices, we do not examine every transaction, activity or area. Instead, based on our risk assessment for the year ended June 30, 2017, the areas examined were those representing the highest risk of fraud, loss, abuse, or noncompliance. The following areas were examined during this audit period:

- Financial Condition and fiscal sustainability
- Controls over implementation of new financial and tenant software
- Cash Receipting to include tenant rents, petty cash and timeliness of deposits
- Accounts payable and payroll disbursements to include general disbursements, credit card activity, travel expenditures and reimbursements, wages, leave accruals and balances and employee benefits
- Conflict of interest related to a real estate transaction

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2017-001 The Housing Authority's financial condition puts it at risk for not being able to meet its obligations or maintain operations.

Background

Housing Kitsap owns and operates eight rental properties and is partner to six Tax Credit Partnership properties, including about 950 units, which serve low-income citizens in Kitsap County (excluding Bremerton). Revenue consists mainly of tenant rents, federal government grants and subsidies, including housing assistant payments and management fees.

Description of Condition

We analyzed the Housing Authority's financial condition for fiscal year 2017, as well as actual and projected cash flow through December 2018. The Housing Authority's unrestricted net position has remained negative for the past five years, while the debt load continued to increase. The Housing Authority's financial activities for 2017 and into 2018 continue to reinforce a decline in its financial health. Our current audit identified the following concerns:

- Based on the Housing Authority's current cash flow projections, at the end of fiscal year 2018 the Housing Authority will have about \$436,000 available in unrestricted cash. This represents a decrease in unrestricted cash of about \$1.8 million, or 80 percent, since the beginning of fiscal year 2018.
- Debt principal and interest payments remained high at 32.5 percent of operating revenue. The Housing Authority reported \$41.8 million in long-term debt at the end of fiscal year 2017.
- Federal operating grants and subsidies declined 8 percent during fiscal year 2017. Additionally, due to issues with a software conversion in August 2017, the Housing Authority has not been able to fully calculate or claim indirect costs as part of grant reimbursements. In the past, some grants have been reimbursed up to 43 percent for indirect costs.
- In the process of reviewing and evaluating collectability of long-term receivables, the Housing Authority wrote off bad debt expense of \$447,513 in fiscal year 2017 and noted another \$486,583 as doubtful. The Housing Authority anticipates additional write-offs during the next fiscal year.
- The Housing Authority was not collecting reimbursement of all debt payments, payroll costs or management fees owed by component units. The

Housing Authority reported \$1.3 million at 2017 fiscal year-end in current receivables from the component units.

- The Housing Authority reported its unrestricted net position as negative \$4 million at the end of fiscal year 2017. Although this is an improvement over the negative \$10.5 million reported in fiscal year 2013, the improvement is offset by a decrease of about \$4 million in net investment in capital assets over the past four years, indicating assets are being sold.

Cause of Condition

In addition to the Housing Authority's declining operating revenue and an increase in operating expenditures, as noted above, we have identified the following factors affecting the Housing Authority's financial condition:

- The Housing Authority's ability to raise rents is limited because of contract limitations imposed by the U.S. Department of Housing and Urban Development (HUD) and the U.S. Department of Agriculture Rural Development.
- The Housing Authority did not approve a fiscal year 2018 budget until February 2018, eight months after the beginning of the fiscal year. Without an approved budget, management and the Board of Commissioners were not able to adequately track revenue and expenses.
- Software conversion issues (see Finding 2017-002) prevented the Housing Authority from being able to produce accurate financial information for grantors, bondholders or other financial information users, as well as expenses for reimbursement from component units.

Effect of Condition

The Housing Authority does not have sufficient unrestricted cash reserves to meet future obligations. Current projections show the Housing Authority is at risk of not being able to pay obligations as they come due after September 2018.

Recommendations

We recommend the Housing Authority establish a formal financial plan to address its cash flow issues and sustainability. Management and the Board of Commissioners should closely monitor and evaluate the Housing Authority's financial activities to ensure the plan is being followed, the desired results are achieved and the plan is revised as needed to resolve the Housing Authority's cash flow issues.

Housing Authority's Response

Cash flow and sustainability have been issues for Housing Kitsap since the recession. However, it should be noted that Housing Kitsap has not failed to pay its obligations throughout 2017 and, to date, in 2018; nor will it. However, and consistent with the recommendations of the State Auditor, Housing Kitsap proposed a multi-tiered plan to its Board of Commissioners to address the current cash flow and sustainability issues. The initial phases of the plan were approved by the Board and are being implemented immediately. The initial phase anticipates accessing more than \$600,000 in cash through project distributions, additional funds from waterfall payments from property partnerships, and personnel savings from restructuring. Later tiers of improvements will include cash and cost saving measures, realizing efficiencies from the new software, restructuring debt on some properties, and if necessary, additional adjustments to staffing. The Board of Commissioners established in June, 2018, a Finance Committee that includes three board members to monitor cash, operations, the implementation of the current ideas in the plan, as well as review any new initiatives. The committee will meet with staff several times during each month and provide updates to the full Board.

Auditor's Remarks

We thank the Housing Authority for their response and appreciate the steps the Housing Authority is taking to address this issue. We will continue to monitor the Housing Authority's financial condition.

Applicable Laws and Regulations

RCW 43.09.200 Local government accounting; Uniform system of accounting, requires the State Auditor to prescribe the system of accounting and reporting for all local governments.

The *Budgeting, Accounting and Reporting System (BARS) Manual*, 3.1.3, Internal Control, requires each local government to establish and maintain an effective system of internal controls that provides reasonable assurance that the government will achieve its objectives.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

2017-002 The Housing Authority did not have adequate internal controls to ensure financial, tenant and other data converted and subsequently entered into its new software system was accurate, complete and validated.

Background

Housing Authority management and the Board of Commissioners are responsible for the Housing Authority's performance, compliance and financial reporting. This includes implementation and use of software to capture, share and report the Housing Authority's financial, tenant and other data.

Description of Condition

In August 2017, the Housing Authority converted to a new software system to record, track and report its financial and tenant data. Although the Housing Authority implemented new software in August 2017, the new system still is not fully functioning, almost a year later.

Cause of Condition

The software selection process does not appear to have been thorough enough to ensure the software met the Housing Authority's needs. At the time of conversion, the Housing Authority did not run the new system parallel with the old one, perform any testing of the new system or retain a documented crosswalk between the old and new systems. The Housing Authority placed high reliance on the software vendor to resolve data transfer and implementation issues and did not request the vendor provide documentation of validations or reconciliations at the time of conversion.

Additionally, Housing Authority management made account code changes during the conversion process but did not create or retain sufficient documentation, verification or reconciliation of the changes to ensure account code changes were appropriately mapped and functioning correctly. This increased the risk of incomplete or inaccurate data.

Effect of Condition

We identified the following:

- Housing Authority staff were unable to reconcile cash to the general ledger.
- Payroll could not be uploaded or entered into the system, resulting in overstated cash and understated expenses.
- Interfund transactions were not posted to the correct receivable account codes. As a result, the Housing Authority could not identify which funds transactions relate to nor complete transfers to or from restricted funds.
- Capital asset information in the new system was not complete, with over 850 accounts missing account coding or depreciation. Depreciation expense cannot be calculated or determined at this time.
- Tenant receivable beginning balances did not properly convert to the new system. Although the Housing Authority could identify differences, corrections were not made in the new system. This poses a risk of uncollected receivables when tenants move out.

Without complete and accurate data, the Housing Authority cannot produce reliable financial statements and is at risk of non-compliance with state and federal requirements, tax credit partnership agreements and bond covenants.

Recommendations

We recommend the Housing Authority take the necessary steps to resolve the errors and issues noted above. Additionally, when implementing new software, the Housing Authority should ensure software has been properly evaluated, will meet the Housing Authority's needs and will allow for validation and testing of data to ensure financial, tenant and other data is accurate and complete. This includes retaining documentation supporting the validation process and a crosswalk of accounts between the two systems.

Housing Authority's Response

Housing Kitsap's conversion to new software over the past year has been problematic. However, we disagree with the SAO's finding regarding the vendor selection process. Housing Kitsap followed its procurement guidelines with a competitive process, held information gathering meetings, held trial and testing sessions, interviewed vendors, consulted with all departments, and checked references by talking with current users of the same software over and above the ones submitted by the vendor. Further, we disagree with some of the SAO's other statements regarding data and coordination. Housing Kitsap does have records of the account code changes and mapping and Housing Kitsap did test and, to the best

of its ability attempted to validate and guarantee the data with the software company. The inability to solve problems with software fixes, that new and/or custom software modules would not be available in a timely way, and the problems resulting from incomplete or inaccurate conversion of historical data all proved unresolvable. Early in 2018, Housing Kitsap negotiated a contract with an alternative housing and financial software system. And, Housing Kitsap has been implementing that conversion for the last few months. This process, which involves the direct, manual input of data is already proving successful. In partnership with the software company's project managers, Housing Kitsap expects to have both the property and financial management systems fully integrated and operational by the 4th quarter of 2018. Implementation of the system is one of the cash flow and sustainability plan elements that the Finance Committee, as noted in the previous section, will track on a regular basis.

Auditor's Remarks

We thank the Housing Authority for its response and appreciate the steps the Housing Authority is taking to address this issue. The work we completed during the audit demonstrated the selected software did not meet the Housing Authority's needs. Additionally, throughout the duration of audit, we requested validation documentation, testing documentation, a documented crosswalk between the old and new system and documented mapping of accounts but were not provided this information from the Housing Authority staff or management. We reaffirm our finding and will review this condition during our next audit.

Applicable Laws and Regulations

RCW 43.09.200. Local government accounting; Uniform system of accounting, requires the State Auditor to prescribe the system of accounting and reporting for all local governments.

The Budgeting, Accounting and Reporting System (BARS) Manual, 3.1.3, Internal Control, requires each local government to establish and maintain an effective system of internal controls that provides reasonable assurance that the government will achieve its objectives.

The Budgeting, Accounting, and Reporting System (BARS) Manual, 3.14, Accounting Principles and Internal Control, outlines the local government's responsibility for obtaining and retention of original vouchers, receipts and other documents.

RELATED REPORTS

Financial

Our opinion on the Housing Authority's financial statements and compliance with federal grant program requirements is provided in a separate report, which includes the Housing Authority's financial statements. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

Federal grant programs

We evaluated internal controls and tested compliance with the federal program requirements, as applicable, for the Housing Authority's major federal programs, which are listed in the Schedule of Findings and Questioned Costs section of the separate financial statement and single audit report. That report includes a federal finding regarding the Housing Authority's inadequate internal controls to ensure allowable cost/cost principles requirements for its Rural Self-Help Technical Assistance Program are met. That report is available on our website, <http://portal.sao.wa.gov/ReportSearch>.

INFORMATION ABOUT THE HOUSING AUTHORITY

Housing Kitsap serves all of Kitsap County excluding the city of Bremerton. The Housing Authority has formed nonprofit organizations and limited partnerships to facilitate acquisition and construction of public and private housing and other community developments. The Housing Authority owns and operates 942 units of affordable housing in 29 dwelling complexes including low rent public housing, independent living facilities for low-income seniors and housing with specialized services for chronically ill people. It has been offering and administering the U.S. Department of Agriculture's Mutual Self-Help Program in Kitsap and surrounding counties since 1973 and contracts with the Bremerton Housing Authority to administer the Section 8 Housing Assistance Payments Program.

The Housing Authority is administered by a seven-member Board of Commissioners: three Kitsap County Commissioners, the mayors of the cities of Port Orchard and Poulsbo, a Council Member of the city of Bainbridge Island, and a resident from one of the Housing Authority projects. The Board appoints an Executive Director to oversee the housing Authority's daily operations as well as its approximately 54 employees. The Housing Authority receives revenue from a variety of sources, including rent from tenants, federal and state grants, proceeds from sales of property, property management fees and developer's fees.

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Information current as of report publish date.

Audit history

You can find current and past audit reports for the Housing Kitsap at <http://portal.sao.wa.gov/ReportSearch>.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

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