Issue Date
October 8, 2004
Audit Case Number
2005-FW-0001

TO: Michael M. Liu, Assistant Secretary for Public and Indian Housing,

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FROM: D. Michael Beard, Regional Inspector General for Audit, 6AGA

SUBJECT: Housing Authority Employee Pension Plan Forfeitures
Public and Indian Housing

INTRODUCTION

We completed an audit of public housing authority employee pension plan forfeitures. We did the audit to highlight the need for a change to HUD's guidance regarding pension plan forfeitures. Our objective was to determine the amount of funds housing authorities could put to better use if HUD changes its policy and requires public housing authorities with private defined contribution pension plans to return pension plan forfeitures to the federal housing programs. The audit contains one finding.

To achieve the objectives we:

- Reviewed HUD Handbooks, Annual Contribution Contracts, Code of Federal Regulations, and Office of Management and Budget (OMB) Circulars that apply to Public Housing Employee Benefits.
- Reviewed data from HUD's PIH Information Center (PIC) System to identify public housing authorities with low rent units.
- Reviewed the latest audited financial statements of all (3,176) public housing authorities in HUD's Financial Assessment Submission-PHA (FASPHA) system to identify public housing authorities with defined contribution pension plans and employer contributions.
- Calculated the amount of annual forfeitures using estimates based on the actual percentage of pension forfeitures to total employer contributions from 359 housing authorities. The 359 housing authorities, from 24 states, represent 28 percent of the total 1,281 housing authorities with private defined contribution pension plans. The calculation assumes that the percentage of pension forfeitures to employer contributions is average for most housing authorities.

- Interviewed officials and obtained pension data from the Housing-Renewal and Local Agency Retirement Plan (HRLARP). HRLARP is one of the largest private defined contribution pension plan administrators for housing authorities. HRLARP, a nonprofit trust, provided the fiscal year 2003 actual forfeitures for 357 housing authorities.
- Interviewed staff from HUD and the San Antonio Housing Authority Pension Plan administrator and trustee when appropriate. We obtained the actual forfeitures data for the San Antonio Housing Authority from the trustee.
- Obtained pension plan data from 28 state retirement systems to ensure we excluded from our calculations housing authorities that participate in state retirement plans.
- Reviewed HUD's 2004 Public and Indian Housing budget.

We conducted the audit from December 2003 through July 2004 in accordance with generally accepted government auditing standards.

In accordance with HUD Handbook 2000.06, REV-3, within 60 days, please provide us for each recommendation without a management decision, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact Jerry Thompson, Assistant Regional Inspector General for Audit, at (817) 978-9309.

SUMMARY

The objective of the audit was to determine the amount of funds that could be put to better use if HUD changes its policy and requires public housing authorities with private defined contribution pension plans to return pension plan forfeitures to the benefit of contributing federal programs. HUD's current policy, contained in Handbook 7401.7G, Section 2-8e, allows housing authorities with defined contribution pension plans to reallocate forfeitures of separating employees to other plan participants or to reduce employer contributions or administrative costs. The policy that permits authorities to allocate forfeitures to other plan participants is inconsistent with the Office of Management and Budget's Cost Principles for State, Local, and Indian Tribal Governments, OMB Circular A-87. The cost principles require the federal government to receive an equitable share of any previously allowed pension costs that reverts or inures to the governmental unit. We believe that HUD could put about $5,300,000 a year to better use if HUD requires housing authorities to refund or credit pension plan forfeitures to the federal housing programs that incurred the original pension costs.

On October 10, 2002, we issued a memorandum to the Assistant Secretary for Public and Indian Housing, addressing the results of the survey we completed at the San Antonio Housing Authority. Our survey disclosed the housing authority followed HUD's policy but HUD's policy was inconsistent with Federal Cost Principals for State and Local Governments. Our survey recommended an audit to determine the need for HUD to change the policy to require public housing authorities to refund the forfeitures to the federal housing programs that incurred the previously allowed costs. Before we initiated an audit, we asked for the Assistant Secretary's comments on the matter.

On July 28, 2003, the Assistant Secretary, Office of Public and Indian Housing, responded to our San Antonio Housing Authority survey. He said the Office concurs with our recommendation to change the guidance for forfeitures to be consistent with the provisions of OMB Circular A-87. He also said the Office supports the view that forfeited funds could be put to better use by reallocating them to HUD programs impacted to improve their operational efficiency. The letter stated that the office would revise Handbook 7401.7G, Section 2-8e. However, as of the date of this report, the revision has not been processed.

We are recommending the Office of Public and Indian Housing process the policy revision, as stated in the July 28, 2003 letter, and promptly distribute the policy change to the housing authorities.

We provided a copy of a draft of this report to the Assistant Secretary for Public and Indian Housing on August 16, 2004, and received a response verbally from the Office of Public Housing on September 29, 2004. Officials of the Office of Public Housing agree with the finding and recommendation and established April 30, 2005, as the date they will complete the action to implement the recommendation. The Assistant Secretary for Public and Indian Housing elected not to provide a formal written response to this report.

BACKGROUND

In fiscal year 2004, HUD allocated $23.5 billion dollars in subsidies and grants to the Office of Public and Indian Housing. More than 3,000 public housing authorities across the nation use these funds to provide housing and related services to qualified participants. In fiscal year 2003, public housing authorities used more than $6.2 billion dollars to pay salaries and fringe benefits of employees who administer the housing programs, maintain the housing units, and protect the tenants and their units. HUD's annual contribution contracts require housing authorities to comply with all tribal, state, and federal laws, applicable to employee benefit plans and other terms of employment. Federal cost principles define pension contributions as fringe benefits provided as compensation for services. Housing authorities allocate or charge pension plan costs to various housing programs in the same way as employee salaries and wages.

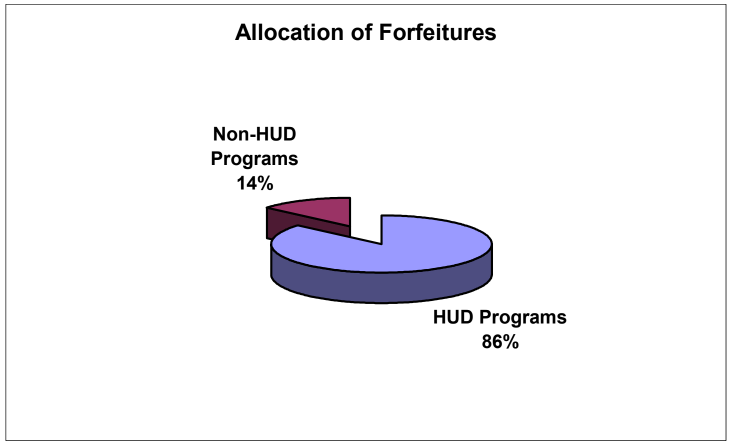
Housing authorities with defined contribution pension plans usually contribute an amount into the pension plan based on a percentage of the employee's salary or wages. Although employees may contribute a portion of their salary to the pension plan, only the housing authority's contribution is a pension cost. Employees are immediately fully vested in their own contributions. However, employees are not immediately vested in the housing authority's pension plan contributions. Employees vest in the housing authority's contributions based on their years of continuous service. Vesting schedules may vary from 3 to 7 years, but employees usually begin to vest in a percentage of the employer's contributions after 1 year of service. For example, a 7-year vesting schedule could be 1 year (10 percent), 2 years (20 percent), 3 years (30 percent), 4 years (40 percent), 5 years (60 percent), 6 years (80 percent), and 7 or more years (100 percent).

Using the above example, if an employee separates from service before completing 3 years, the employee is fully vested in his or her own contributions plus earnings and only 20 percent vested in the employer's contributions. If the employee contributed $1,000 of his or her salary to his pension plan, during his or her time of service, the employee is entitled to the $1,000 and any related earnings. If during that same period, the employer contributed $1,000 to the employee's pension account, the employee is only entitled to $200, or 20 percent, plus any related earnings. The separating employee forfeits his or her right to $800 and related earnings. The $800 is the portion of the employer's contribution in which the employee is not yet vested. The employee is only entitled to $1,200 plus any related earnings from the pension plan. The $800 plus earnings is a forfeiture that reverts to the housing authority. The housing authority, following HUD guidance, can allocate the $800 in forfeitures to the remaining pension plan participants or reduce its plan contributions or administrative costs.

We decided an audit of public housing authorities' employee pension plan forfeitures was appropriate after we found that from January 1, 1999, through March 31, 2001, the San Antonio Housing Authority reallocated $406,624 in forfeitures of separating employees to the other plan participants instead of refunding or crediting the housing programs that incurred the previously allowed pension costs. The housing authority followed the Office of Public and Indian Housing's (HUD) policy that allows this. HUD's policy, implemented in 1988, allows housing authorities to reallocate forfeitures to the other participants or to apply the forfeited contributions to reduce costs. The provision that allows the reallocation of forfeitures to other plan participants does not comply with OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments. The cost principles require the federal government to receive an equitable share of any previously allowed pension costs that reverts or inures to the governmental unit. We provided a copy of our survey report to the Assistant Secretary for Public and Indian Housing who advised us he would change HUD's policy to require housing authorities to return pension plan forfeitures to the federal housing programs, effective with plan years beginning after December 31, 2003. However, as of the date of this report, HUD's published policy has not changed.

To illustrate the effect of allocating the forfeitures to the other plan participants, we did a detailed analysis of the San Antonio Housing Authority's (Authority) 2001 forfeitures. During 2001, the Authority had 38 employees separate service with forfeitures totaling $111,922. The Authority used $966 to reinstate the benefits of one rehired employee and allocated $110,956 to the other plan participants. Based on the salary allocations of the 38 employees, following federal cost principles, HUD programs were due $95,962 for their share of 86 percent of the forfeitures in fiscal year 2001.

HUD Public Housing-Low Rent	$	77,495
HUD PHDEP Program	$	5,688
HUD Hope VI Program	$	4,470
HUD Section 8 Program	$	8,309
HUD Programs	$	95,962
Non-HUD Programs	$	14,994
Total Net Forfeitures	$	110,956



If the Authority had used forfeitures to reduce employer pension contributions by program or received a cash refund, the cost savings generated would have allowed the housing funds to be put to better use. The Authority could have addressed additional urgent housing needs it could not have otherwise met due to the limited operating subsidies and grants they received. The Authority could have used the 2001 forfeitures by applying $77,495 to improve the physical condition of the public housing units; $5,688 to keep crime and drugs away from children living in public housing units; $4,470 to provide affordable homeownership to public housing residents; and $8,309 to provide vouchers to low-income families who need housing assistance. The pension plan participants who received an allocation of forfeited pension benefits did not provide any additional service or benefit to the HUD program that incurred the previously allowed pension costs.

HUD has allowed housing authorities like the San Antonio Housing Authority to reallocate pension plan forfeitures since 1988. From January 1999 through March 2001, the Authority reallocated $406,624 in retirement benefits to the other plan participants. The potential magnitude of monetary losses to HUD programs is significant considering that the San Antonio Housing Authority is only one of more than 3,000 housing authorities nationwide.

FINDING

HUD Could Save More Than $5 Million Annually by Requiring Housing Authorities to Refund Pension Plan Forfeitures to Housing Programs

HUD's policy allows public housing authorities with defined contribution pension plans to reallocate pension plan forfeitures to the other pension plan participants. This policy is not consistent with federal cost principles and has the effect of reducing the potential effectiveness of federal housing programs. We estimate that HUD will save approximately $5,300,000 per year if it changes its policy and requires public housing authorities to refund or credit pension plan forfeitures to the housing programs that incurred the previously allowed pension costs.

HUD Requirements

The HUD Annual Contributions Contract requirements incorporate Title 24 of the Code of Federal Regulations and other state and federal laws that apply to public housing authorities, including employer requirements for employee benefits plans (Sections 5 and 14A). The HUD Annual Contributions Contract requires compliance with all tribal, state, and federal laws applicable to employee benefit plans and other conditions of employment.

Code of Federal Regulations, Title 24, Part 85.1, establishes the uniform administrative rules for federal grants and cooperative agreements and sub-awards to state, local and Indian tribal governments. Part 85.22 also establishes OMB Circular A-87 as the cost principles for housing authorities to follow when determining allowable costs to federal programs.

OMB Circular A-87, Attachment A, Section C, provides basic guidelines on allowable costs. These guidelines include requirements that all costs charged to a federal award must be necessary, reasonable, adequately documented, net of all applicable credits, and allocated in accordance with relative benefits received. Further, Section C 4.a. states, "Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs." This section also states, "To the extent such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate."

OMB Circular A-87, Attachment B, Section 11 d., provides principles to be applied regarding fringe benefits. The principles include, except as provided elsewhere in the principles, that the costs of fringe benefits are allowable. Pensions are fringe benefits provided by employers as compensation for services. Employers will allocate or charge pension plan costs to federal awards in the same manner as employees' salaries and wages.

In addition, OMB Circular A-87, Attachment B, Section 11 e., Pension plan costs, states, "The Federal Government shall receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit."

HUD Guidebook 7401.7G, Employee Benefit Plans, provides guidance to housing authorities on pension plans. Chapter 2, Private Retirement Plans, Section 2-8 (e) states that all defined contribution plans may either reallocate forfeitures to the accounts of other plan participants or use them to reduce contributions or administrative costs. Chapter 1, General Provisions, Section 1-3 and 1-4 state that HUD Annual Contributions Contract requirements still apply to employee benefit plans and that HUD policies, as well as other federal laws and regulations, continue to apply to housing authorities. These provisions have been in effect since 1988.

Calculation of Forfeitures

We calculated that HUD could realize about $5,300,000 in annual benefit to its housing authority programs just by changing its policy on housing authority pension plan forfeitures.

According to HUD's PIH Information Center (PIC) System, there are 3,176 public housing authorities in the United States with low rent units. We reviewed the data in the Notes to the Financial Statements from the most recent audited financial statements in HUD's Financial Assessment Submission-PHA (FASPHA) system to determine the types of pension plans being used.

We identified 1,281 of the 3,176 housing authorities, in 43 states, as having defined contribution pension plans. We identified 1,034 housing authorities with other types of plans and were unable to determine the types of pension plans used by 861 housing authorities without contacting each housing authority individually. We independently verified through State Retirement Systems that none of the housing authorities we used in our calculation were included in their plans.

The Notes to the Financial Statements identified the majority of the private insurance companies and outside trustees that administer the 1,281 defined contribution pension plans. Only 365 plans did not specifically mention a plan administrator. Of the 1,281 housing authorities, the Notes to the Financial Statements for 66 did not contain the amount of pension plan contributions that we could use to calculate forfeitures, so we did not attempt to calculate forfeitures for these authorities. Therefore, we only used either actual or calculated forfeitures for 1,215 housing authorities.

We obtained actual forfeitures for 359 housing authorities. We contacted the Housing Renewal and Local Agency Retirement Plan who provided us actual amounts of forfeitures and employer contributions for 357 housing authorities in 24 States for fiscal year 2003. The Housing Renewal and Local Agency Retirement Plan is one of the largest private and exclusive defined contribution pension plan administrators for housing authorities. We obtained the actual forfeitures for two other housing authorities from our review of the financial statements mentioned above or from previous audit work.

In our calculation, we estimated the forfeitures of 856 housing authorities using the average actual forfeiture percentage of employer contributions of the 359 housing authorities for which we had complete information. The average percentage of forfeitures to employer contributions was 6.5 percent. When only total contributions were available we calculated employer contributions by using the actual ratio of employer contributions to total contributions of the 359 housing authorities for which we had complete information. The employer and employee contributions percentages were 60 percent and 40 percent, respectively, of total pension contributions. We added the calculated forfeitures for the 856 housing authorities to the actual forfeitures of the 359 for which we had complete information to arrive at the total forfeitures for the 1,215 housing authorities.

	Housing Authorities	Employer Contributions	Estimated Forfeitures	Actual Forfeitures	Total Forfeitures
Calculated	856	$65,607,711	$4,264,501		$4,264,501
Actual	359	$15,901,115		$1,033,465	1,033,465
Totals	1,215	$81,508,826	$4,264,501	$1,033,465	$5,297,966

As indicated by the table above, we estimated pension plan forfeitures to be about $5,300,000 in a 1-year period. Considering this calculation, and disregarding the housing authorities that may have had defined contribution plans that we excluded from this calculation, we believe HUD could ensure the return of at least that amount annually to HUD programs by implementing our recommendation to change its policy on pension plan forfeitures.

HUD Officials Concur and Plan to Change Guidance to Comply with Federal Cost Principles

On October 10, 2002, we issued a memorandum to the Assistant Secretary for Public and Indian Housing addressing the results of the San Antonio Housing Authority survey. Our survey disclosed that the housing authority followed HUD's policy but HUD's policy was inconsistent with Federal Cost Principles for State and Local Governments. Our survey recommended an audit to determine the need for HUD to change its policy to require public housing authorities to refund the forfeitures to the federal housing programs that incurred the previously allowed costs. Before we initiated an audit, we asked for the Assistant Secretary's comments on the matter.

In a letter dated July 28, 2003, the Assistant Secretary for Public and Indian Housing stated that the Office of Public and Indian Housing concurs with our recommendation to change the guidance for forfeitures to be consistent with the provisions of OMB Circular A-87. The Office of Public and Indian Housing also agreed that operational efficiency would be improved if forfeited funds were applied to HUD programs. The letter stated that the Office of Public and Indian Housing would revise Handbook 7401.7G Section 2-8e to reflect the following change: "Forfeitures. All defined contribution plans must use employee retirement plan forfeitures, refunds, withdrawals, and other credits as a cash refund to the Federal Program for its share of previously allowed pension cost. This requirement is effective for plan years beginning after December 31, 2003."

As of the date of this report, HUD has not processed this revision.

AUDITEE COMMENTS

On September 29, 2004, the Office of Public Housing Officials indicated verbally they agreed with the report and stated they will change HUD handbook 7401.7G to state that all defined contribution plans must use employee plan forfeitures, refunds, withdrawals, and other credits as a cash refund to the federal program for its share of the previously allowed pension cost. They will make the change and notify all public housing authorities. They said the final action target date is April 30, 2005. They indicated they would like to have this recorded as a Management Decision. The Assistant Secretary for Public and Indian Housing elected not to provide a formal written response to this report.

OIG EVALUATION OF AUDITEE COMMENTS

HUD officials agree with the finding and recommendation. We are recording the response from the Office of Public Housing as a Management Decision in HUD's Audit Resolution and Corrective Action System.

RECOMMENDATIONS

We recommend the Assistant Secretary, Office of Public and Indian Housing:

1A. Process the revision to Handbook 7401.7G Section 2-8e, as stated in the July 28, 2003 memorandum, and distribute the revised policy to public housing authorities.

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS PUT TO BETTER USE

Recommendation Number	Funds Put to Better Use[1]
1A	$5,300,000

[1] Funds put to better use are costs that will not be expended in the future if our recommendations are implemented. These funds will be returned to the federal programs increasing program effectiveness.