OFFICE OF THE
City Auditor

# Non-Profit Housing Corporation (homeEd) Financial Review

January 5, 2011

The Office of the City Auditor conducted this project in accordance with the *International Standards for the Professional Practice of Internal Auditing*

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# Executive Summary

City Council authorized the establishment and incorporation of homeEd in 1977. The objective of City of Edmonton's Non-Profit Housing Corporation (homeEd) is to develop, provide, operate and maintain housing accommodations of all kinds. Currently, homeEd owns and operates 19 properties with a total of 806 housing units. The rental units include apartments and townhouses throughout Edmonton. All 19 properties are funded by some level of Government as a result of agreements with Canada Mortgage and Housing Corporation (CMHC), Alberta Home Mortgage Corporation (AHMC), various Province of Alberta Ministries, and the City of Edmonton (City).

homeEd's 19 properties are categorized into two Divisions. These Divisions differ by mandate and by the type of funding:

- ***Division 1*** was established in 1977 and includes properties under subsidy operating agreements with CMHC and AHMC. Division 1 contains 14 properties with a total of 658 units. Division 1 operates with the mandate to provide non-profit housing.

- ***Division 2*** was established in 2008 and has properties that were either purchased or developed through a combination of capital grants from the City of Edmonton (the City) and from the Province of Alberta. Division 2 currently consists of five properties with a total of 148 units. Division 2 operates with the mandate to provide affordable housing for lower income tenants, homeless, and individuals with special needs.

The Office of the City Auditor (OCA)conducted a review of the financial operating control processes at homeEd. Specifically, we reviewed the adequacy of controls that support homeEd's Revenue and Expense processes.

Our key observations include the following:

***1. Practices to determine rental rates for Division 1 need to be consistent with the agreements.***

Division 1 agreements contain clauses that result in two competing priorities for homeEd. Specifically:

1) The need to ensure that revenues are sufficient enough to break even so that the corporation remains a going-concern; and
2) The need to ensure that families with low and moderate incomes receive priority for Division 1 units.

We observed that many of homeEd's current practices support the objective to operate homeEd in a sustainable manner, and on a not-for-profit basis. This is evident in their practices to establish minimum rent, charge maximum rent in the absence of income verification, and in how the Fixed Rate Rent Supplement funding has been applied.

homeEd does annually disclose its financial performance to the CMHC/AHMC by providing them with a copy of their audited financial statements as well as project data reports which summarize the annual financial activity for each property. In response to homeEd's most recent submission, (i.e. 2009 Annual Financial reporting Package), the CMHC accepted the information as submitted. Management therefore feels that this acceptance is an indication of CHMC's/AHMC's approval of their practices.

We consulted with the Law Branch and have confirmed that the grant funding agreements are in effect and apply to all Division 1 suites. While we understand the practicality of some of homeEd's practices to evolve outside of the agreements, our conclusion is that homeEd's practices should be better aligned to address homeEd's competing priorities and the express requirements of its agreements.

**2. *Practices to determine Rental Rates for Division 1 and Division 2 need to be formalized into written policies and procedures.***

We observed that homeEd's practices to assess tenant eligibility, to set the rental range for the units, to verify tenant income and finally to calculate the tenant rental rates are not adequately documented in formal written policies and procedures. Doing so would standardize homeEd's current practices and more importantly will provide homeEd with a documented basis to justify its rental rate decisions.

**3. Expand the policy over expense approvals to ensure consistency in approval practices**

We observed that homeEd's procedure to approve expenses and purchase orders was not always applied consistently and thus we found a few instances of expenditures that were not approved according to homeEd's authorization process. While management has created a procedure to approve capital expenditures that are the result of pre-approved capital budgets, we believe that the development and establishment of a separate and comprehensive approval policy will assist management in its attempt to monitor cash-flows.

**4. *Expand the current tendering process to ensure that homeEd receives value for money for major capital repair projects.***

We observed that the review and selection of the vendors for major capital repair projects (e.g. complete building window replacements, roof replacements, etc.) is not documented. Also, discussions with management confirm that tendering for these large projects are not made publicly available (e.g. offer to tenders is not advertised in newspapers by homeEd). Instead, depending on the nature and scale of the project, the work is either sole sourced or there is a bid invitation to contractors already known to homeEd. Further, homeEd's current tendering process could be enhanced by including more information. Specifically, information that pertains to:

- The selection/evaluation criteria,
- Vendor requirements (i.e. insurance),
- Minimum number of vendors to request a proposal form,
- Public tendering versus sole sourcing,

- Dollar limits for contract approval, etc.

As a non-profit organization that receives public funding to support its operations and various initiatives, homeEd must ensure that it is receiving the best value-for-money when incurring significant expenditures for capital costs. Documented price comparisons and open and competitive tendering practices are just some ways to achieve this.

**Recommendations**
To address our observations, we have directed three recommendations to homeEd management:

1. The OCA recommends that the GM of the City of Edmonton Non-Profit Housing (NPH) Corporation obtain clarification from the NPH Board on the meaning of "housing accommodation of all kinds" to guide the NPH's decision making processes. Specifically, this includes:
    - In Division 1, clarifying which priority takes precedence, break even vs. giving priority to low to moderate income tenants.
    - In Division 2, clarifying the purpose of affordable housing, particularly, whether homeEd should be servicing income challenged tenants, lower income tenants, homeless tenants, or tenants on government assistance.

2. The OCA recommends that the GM of the City of Edmonton Non-Profit Housing Corporation review current processes and procedures to ensure alignment to signed operating agreements. Where current processes are not aligned, clarification and/or amendments to the operating agreements should be in place to ensure that homeEd is not in breach of the agreements. These areas include:
    - Procedures in place to calculate a tenant's rental rate.
    - Income verification requirement.

3. The OCA recommends that the GM of the City of Edmonton Non-Profit Housing Corporation document its operational policies to provide a framework for operational decision making. A policy should be in place to:
    - Set the minimum and maximum rental range for properties.
    - Define low to moderate income.
    - Define Tenant Eligibility.
    - Determine the calculation of a tenant's rental rate.
    - Allocate the Fixed Rate Rent Supplement Program.
    - Define the Purchase Order process.
    - Define the signing authority $ limits.
    - Update the current tendering policy.

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# Non-Profit Housing Corporation (homeEd) – Financial Review

## 1. Introduction

The Office of the City Auditor (OCA) performed a financial review assessing the adequacy of controls over the revenue and expenditure processes, including policy and procedures, at the City of Edmonton's Non-Profit Housing Corporation. This review was completed at the request of the City of Edmonton's Non-Profit Housing Corporation Board.

The City of Edmonton Non-Profit Housing Corporation is known in the community as ***homeEd***. We will refer to it as homeEd in our report.

## 2. Background

**Organizational Structure**

City Council authorized the establishment and incorporation of homeEd in 1977. The objective of homeEd is to develop, provide, operate and maintain housing accommodations of all kinds. homeEd currently offers two kinds of housing that are separated into two divisions: *Division 1* provides non-profit housing while *Division 2* provides affordable housing.

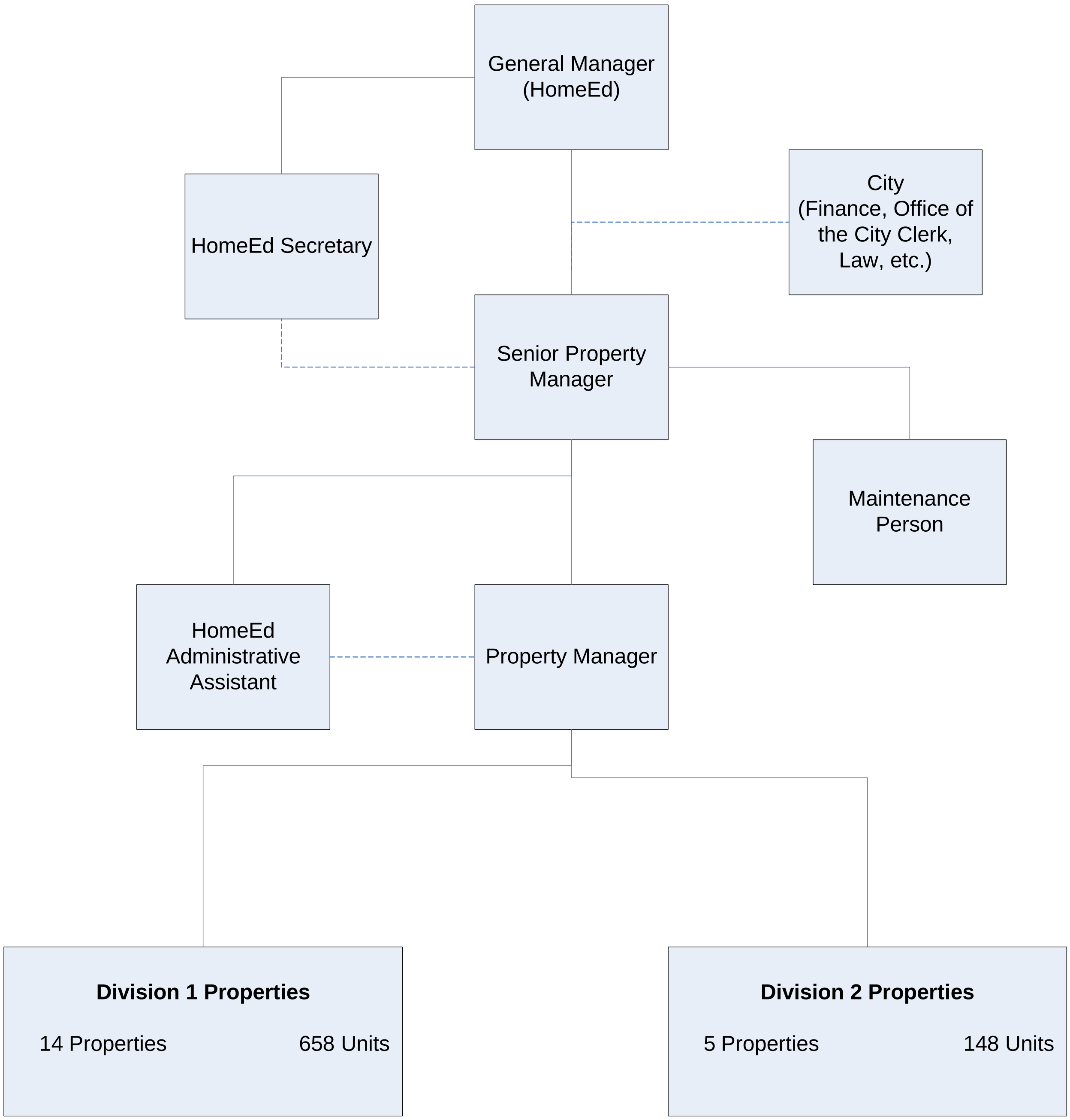
The organization consists of head office staff including the senior property manager, property manager, administrative assistant, and a maintenance person. As well, there is a resident manager for each property. There are also City of Edmonton (City) staff who provide services to homeEd.

Figure 1 displays the organizational chart at homeEd. In general, the job descriptions are as follows:

- General Manager (City) – oversees the entire operation of homeEd as well as strategic planning.
- Secretary (City) – provides administrative duties to both City and homeEd staff.
- Senior Property Manager (homeEd) - manages the daily operation (including the review and approval of all operating expenditures), and develops the budgets.
- Property Manager (homeEd) – resolves tenant issues, first point of contact for resident managers, and responsible for accounts receivables.
- Administrative Assistant (homeEd) – provides administrative duties to the senior property manager.
- Maintenance Person (homeEd) – responsible for basic maintenance/building services and inspections of the properties.

- Resident Managers (homeEd) – each property has a resident manager responsible for completing administrative duties (i.e. application intake, annual income verification forms, rent collection, etc.) as well as the maintenance of their assigned property.

**Figure 1**
**HomeEd Organizational Chart**




HomeEd uses the resources of City departments on an as-needed basis. Finance and Treasury provides a financial oversight role with respect to compliance with accounting and reporting requirements, this includes preparation of the financial statements and processing of payments for accounts payable (homeEd processes accounts receivables). HomeEd also uses the City's financial system (SAP). Cash and cheques received by homeEd are processed through the City's remittance processing. Some departments are used in the capacity of an advisory role, this includes Corporate Services – Risk Management and Planning and Development.

Currently, homeEd owns and operates 19 properties with a total of 806 housing units. The rental units include apartments and townhouses throughout Edmonton. As all 19 properties are partially funded by some level of Government, we conducted our review based on funding agreements homeEd has with the Canada Mortgage and Housing Corporation (CMHC), Alberta Home Mortgage Corporation (AHMC), various Province of Alberta Ministries, and the City of Edmonton.

**Division 1 – Non-Profit Housing**

Division 1 was established in 1977 and currently has 14 properties.

Currently, there are 8 properties (i.e. 399 units) subject to terms with the CMHC. Each property operates under a project operating agreement (agreement) dated between the years 1981-1983. The agreements are in effect and apply to all suites for a 35 year term. Thus these agreements will begin to expire in 2016.

Since their inception, the agreements have been modified only once; for a 3-year period from 1996-1998. Specifically, in 1997, CMHC issued an addendum to provide for additional financial contributions beyond the original agreement. The additional subsidy amount totalled $133,126.

There are 6 properties (i.e. 259 units) subject to terms with the AHMC. Five of the properties operate under a project operating agreement dated 1982. The terms of both the CMHC and AHMC agreements are the same with the exception of the York Street property which has a unique Project Operating Agreement – *Assistance to Non-Profit Corporation with the Alberta Mortgage and Housing Corporation (dated 1993).*

As part of the terms of the agreement, CMHC and/or AHMC make annual contributions to homeEd. This annual contribution helps homeEd with meeting its costs for the rental housing project. With the exception of York Street, the annual contribution is the difference between the current mortgage interest rate and an interest rate of 2% using the original approved capital cost as the base. The contributions are paid over an amortization period of 35 years. For York Street, the annual contribution is the difference between the estimated expenditures net of the estimated revenues each year.

To receive and maintain this funding, homeEd must ensure that its practices are consistent with the agreements. In particular, based on our review of the agreements, key sections from the agreements are:

- Section 2(1) which requires that the principle of blending incomes[1] is to be followed when leasing units in the building, and in applying this principle, priority should be given to families and individuals of low and moderate income.
- Section 8(1) which requires that homeEd operate the project on a break even basis.
- Section 8(2), requires that homeEd ensures the efficient management of the project as well as maintain the project in a satisfactory state of repair and fitness for occupancy.
- Section 17, states that failure to maintain the low and modest rental character of the project would be a fundamental breach of the agreement.

Collectively, these sections highlight two competing priorities for homeEd:

1. The need to ensure that revenues are sufficient to break even so that the corporation remains a going-concern; and
2. The need to ensure that families with low and moderate incomes receive priority for Division 1 units. Management has asserted that the objective to break even supersedes the objective to maintain the low and modest character of Division 1 units.

HomeEd prepares a number of reports as part of its annual disclosure to CMHC. These include:

- Budgets containing individual line items for estimated income and expenses for the applicable property.
- Annual Project Data Reports (PDR) which disclose actual revenues and expenses generated for each property as well as the tenant profile for each property (i.e. household size, unit types, and gross household incomes); and
- Annual audited financial statements that assess the fairness of the financial information presented by homeEd in its financial statements. These financial statements are audited by homeEd's external auditors.

In turn, the CMHC also conducts client visits to homeEd which are formally known as "Client Visits and Operational Reviews." These visits occur every three years, the most recent visit occurring in 2009. Our review of CMHC's 2009 results letter to homeEd indicated that, based on positive previous reviews, the CMHC deemed it unnecessary to perform a detailed comprehensive client visit.

As will be discussed later, CMHC annually sends letters to homeEd that confirm the maximum rent homeEd can charge for units in Division 1 properties.

[1] The blending of incomes within a project will permit tenants at the lower end of the income range to benefit from the subsidy in excess of the average for the project, while those at the midpoint will receive the average subsidy, and those at the upper end will receive less than the average subsidy.

**Division 2 – Affordable Housing**
Division 2 was established in 2008. There are 5 properties in Division 2; all of which are subject to terms of different agreements as listed below. These agreements are dated between the years 2008-2010.

- Brightstar and Lexington are 2 properties with 63 units that are subject to terms with the City's *Cornerstones Plan*. The purpose of the Cornerstones Plan is to provide affordable housing for households who are income challenged[2].
- Fraser is a property with 31 Units and is subject to terms with the City's *Cornerstones Plan Agreement* discussed above, as well as the Province's *Affordable Housing Partnership Initiative (*Affordable Housing Grant*).* The purpose of the Affordable Housing Grant is to provide stable, secure, and affordable housing for lower-income residents, which may consist of lower-income families and persons or households with special needs in high-growth communities.
- Ivy Manor and Barclay Square are two properties with 54 units that are subject to terms with the Province's *Housing for the Homeless*. The purpose of the Housing for the Homeless Grant is to provide housing for homeless individuals. Management has advised however, that the terms under this agreement are currently under renegotiation.

The Division 1 and Division 2 properties also differ in terms of funding. Instead of receiving annual operating contributions, funding for Division 2 properties is *one-time* funding that is provided up front or in instalments to homeEd for the purpose of providing financial assistance for capital costs (i.e. purchasing and/or construction costs). Therefore the challenge for homeEd in managing this particular portfolio is to ensure that adequate financial resources are available to cover the annual cost of operating Division 2 properties.

[2] Income challenged is defined as households who earn less than the median income for their household size and pay more than 30% of that income for housing.

# 3. Scope, Objectives & Methodology

## 3.1. Scope

The scope of this review was limited to a financial review of the day-to-day operations of homeEd, including the financial policies and procedures. Our review covered the period January 1, 2009 to June 30, 2010. Where required, we also reviewed information from 2008. We reviewed the financial controls pertaining to the collection, recording, and reporting of revenues for all 14 properties in Division 1. At the time of our review, 2 properties in Division 2 (i.e. Ivy Manor and Berkley) were under renovation and therefore did not house any homeEd tenants. Therefore, 3 properties were reviewed in Division 2. For expenditures, all 19 properties were reviewed where the focus was on reviewing the financial controls over the approval, payment and recording of expenses.

## 3.2. Audit Objectives

The objectives of this audit were to:

1. Assess the adequacy of the financial policies and procedures used in the recording of financial information associated with daily operations.
2. Assess the reasonability and validity of homeEd's revenue.
3. Assess the reasonability and validity of homeEd's expenses.

## 3.3. Methodology

During the planning phase we reviewed key financial documentation including the internal controls summary, audited statement of revenues and expenses, office procedures, as well as applicable operating agreements. We also interviewed homeEd personnel, City Staff connected to homeEd (i.e. representatives from the Housing Branch and the Finance and Treasury Department) as well as homeEd's external auditors. Collectively, these activities helped us develop our scope, audit objectives, and audit programs.

We randomly selected and completed detailed testing on a sample of tenants from all Division 1 properties. This comprised of 2 tenants from each of the 14 properties for a total of 28 tenant samples. As well, we selected 2 tenants from each of the 3 Division 2 properties which were operational, for a total of 6 tenant samples.

Since Repairs and Maintenance expenses (R&M) is homeEd's most significant expense, we selected and performed detailed testing on 19 R&M expenses (one per property). We also tested 12 non-R&M expenses for validity and salary expenses were also reviewed and tested for completeness.

The Law Branch was consulted to provide a legal opinion on various sections of the operating agreements, and finally, site visits to all of the properties were conducted and interviews with the resident managers were held.

# 4. Observations and Analysis

## 4.1. Policy

homeEd has a variety of documented practices and procedures. These procedures vary in form however they provide guidance to address various day-to-day operational processes and include:

- Internal Control Summary which deals with various items such as disbursements and cash receipts.
- Operational procedures which address new hires, month-end procedures, new move-ins, move-outs, rent collection, tenant application, etc.
- Residential Manager contracts stating their roles and responsibilities as well as their charge-out rates.

These documented procedures contain general statements which describe the internal work processes. The procedures provide step-by-step instruction for completing certain tasks.

homeEd does not have documented policies in place. By definition, a policy addresses recurring issues and provides direction as to the manner in which an organization performs its duty and guides it behaviour. Hence, without documented policies, decisions may be made that are inconsistent with the goals of the organization. Although not an all-inclusive listing, specific areas discussed further in our report that require formal policy direction include:

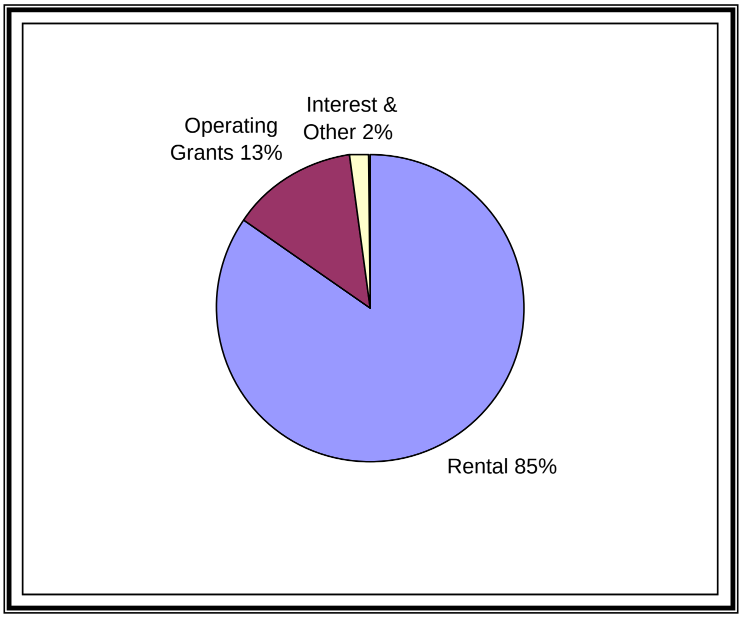
- A Policy to define low to moderate income (See section 4.2.1).
- A Policy on setting the minimum to maximum rental range (See section 4.2.3).
- A Policy on rental rate calculation and allocation of rent supplements (See section 4.2.4).
- A Policy on the purchase order process and setting of signing authority i.e. Dollar limits (See section 4.3.2).
- A Tendering policy (See section 4.3.4).

<u>Conclusion</u>
homeEd needs to develop policies to ensure that management makes decisions based on approved policies of the corporation. Recommendation 3 addresses this point and provides a starting base for other items that may require policies in the future.

## 4.2. Revenue

Revenue is essential to the sustainability of homeEd. For the past 3 years rental revenue has, on average, accounted for approximately 85% of homeEd's total revenue each year. Figure 2 on the following page shows the average proportion of the homeEd's revenue components.

**Figure 2**
**HomeEd's Revenue Proportions (Average of 2007 - 2009)**




Processes to ensure the validity and accuracy of revenues at homeEd can essentially be grouped into two major areas: the ***Rental Rate Determination Processes*** and the ***Collection and Recording Procedures***.

***The Rental Rate Determination Processes*** consist of processes that deal with "how" rental revenues are determined. They are:

- **The Tenant Eligibility Process** - homeEd must ensure that tenants residing at the units are eligible based on the terms of the agreements.
- **Annual Income Verification Process**– homeEd must ensure income verification is completed in accordance with the agreements.
- **Rental Rate Setting Process**- homeEd must ensure that the rental rates (minimum and maximum rent that can be charged for a particular unit) are set in accordance with the agreements.
- **Calculation of Rental Rates Process** - homeEd must ensure that the rental rates charged to tenants are calculated in accordance with the agreements.

***The Collection and Recording Procedures*** consist of procedural controls that result in the timely collection, recording, and reporting of rental revenue.

Our review of rental revenue assessed the validity, accuracy, and adequacy of the controls that make-up the Rental Rate Determination and Collection and Recording processes.

For ease of review, our observations will be presented by process and by Division for the *Rental Rate Determination Process.* The York Street property for Division 1 will also be discussed separately since its agreement terms differ from the other Division 1 agreements. The *Collection and Recording procedures* will be discussed in one section since the procedures are the same across both Divisions.

## Division 1 – Rental Rate Determination Process

### 4.2.1. Div. 1 - Tenant Eligibility

Current Practice

In Division 1, the agreements state that in carrying out the principle of blending incomes, priority must be given to tenants who are low to moderate income. Currently, when a tenant first applies to reside at a Division 1 unit, homeEd will substantiate their income by reviewing annual tax returns, pay-stubs, government income assistance stubs, etc., with the aim to ensure that they fit the definition of low to moderate income.

Verbal discussions with the Senior Property Manager confirmed homeEd's practices to evaluate tenant eligibility. The factors considered include:

1) How many individuals does the tenant support with their income?
2) Is the tenant receiving some form of government income assistance?
3) What type of employment does the tenant have, casual or permanent?
4) Was the tenant referred to homeEd by a social service organization?

OCA Observations

We observed that the Division 1 agreements did not specifically define the concept of "low to moderate income." We also observed that homeEd does not have any documented policies or procedures that define this concept nor policies or procedures to guide its application in determining tenant eligibility.

While homeEd considers a number of factors, the answers to these questions may vary from tenant to tenant and management ultimately determines whether or not a tenant is considered to be of low to moderate income. Although this allows for flexibility, without a documented policy to justify its decision, it may lead to a perception of bias on homeEd's part when tenants have similar qualifications and there is no policy to differentiate one tenant from another.

Through our review of 26 Division 1 tenant files we observed that all of the tenants were eligible since they all had low to moderate incomes at the time of their initial application. Since the agreements do not define what low to moderate income is, we used the following criteria to determine initial eligibility: tenants who relied on some form of government assistance to pay for housing and/or tenants who had employment incomes that were low enough to be able to afford homeEd's rental rates (i.e. See *Rental Rate Calculation* discussion below).

Conclusion

In order to determine tenant eligibility, homeEd should define the concept of "low to moderate income" and formalize it in a documented policy and procedure. This will standardize homeEd's current practice and will provide homeEd with a basis to justify its tenant eligibility decisions.

### 4.2.2. Div. 1 - Annual Income Verification

Division 1 agreements require that homeEd annually confirm a tenant's income. This information is important as it enables homeEd to confirm ongoing tenant eligibility and fulfill the agreement's requirement to determine tenants' rental rates with reference to their income.

Current Practice

homeEd attempts to obtain income verification on a yearly basis by sending out letters to all tenants annually requesting that they confirm their incomes. However, not all tenants provide this information. Tenant's who fail to confirm their incomes are immediately charged the maximum rent[3] and no other methods of confirming income are pursued. This practice is in accordance with the direction provided by CMHC in its 2007 annual *Low End of Market Rent (LEM*) letter to homeEd.

Observation

We confirmed that homeEd sends out letters to tenants requesting income verification. However, homeEd estimates that approximately 35% of tenants in Division 1, who have their leases renewed, did not submit income verification in 2009. Our review of tenant files also showed that income verification is not obtained on a yearly basis for all tenants. In our testing of Division 1 samples (i.e. 26 tenants), we observed that income verification was not received from 5 (19%) samples and these tenants were subsequently charged maximum rent.

The Division 1 agreements state that income verification should be obtained annually. Specifically:

- Section 2(5) states that homeEd shall obtain evidence of the income of the lessees paying rent according to the rent-to-income scale at the time of initial occupancy and annually thereafter. The rent-to-income scale covered all levels of family income including those who had an income of "$508 *and up"* (based on original schedule A, not adjusted for inflation) living in the subsidized units. Therefore, this means that all renters are effectively paying rent according to this schedule and annual evidence of income needs to be obtained.

- Section 2(5) also states that the amount of rent paid by the lessee is to be adjusted in accordance with the change in income; therefore, income verification is required in order to make such adjustments.

- Section 17 requires that the "low and modest rental character" of the project must be maintained. Income verification is required to confirm each renter continues to qualify to reside in a Division 1 property due to their having low to moderate income.

[3] Maximum Rent is a subsidized rent cap. See section 4.2.3 for further rental rate setting discussion.

Additionally, the addendum to homeEd's lease agreement with its tenant's states that tenants are required to notify homeEd of changes in their income and must annually provide proof of their household income that is satisfactory to the landlord (homeEd).

Finally, we consulted with the City's Law Branch who reviewed the Division 1 agreements, and homeEd's tenant lease agreements. They confirmed that income verification is required for all Division 1 tenants.

Conclusion and Recommendation

Our review of the agreements indicates that annual income verification is a requirement to reside in homeEd's Division 1 units. We acknowledge that CMHC's annual LEM letter to homeEd does permit homeEd to charge maximum rent to clients who refuse to verify income. However, in the absence of annual income verification, homeEd increases the risk that it is housing individuals who are not "low to moderate income." Further, it increases the risk that homeEd will not be able to maintain the low to moderate rental character of its Division 1 units, which is also a requirement of the agreement. To address these risks, we recommend that homeEd take the necessary steps to review their current practices pertaining to annual confirmation of income and maintain the low to moderate income character of Division 1 properties. Where the practices are not aligned with the agreements, homeEd should seek amendments to the agreements as appropriate. (Recommendation 2)

### 4.2.3. Div. 1 - Rental Rate Setting

The setting of the minimum and maximum rental rate for each property determines the range of rental rates homeEd is able to charge. homeEd must ensure that the rates are set in accordance with the operating agreements.

Current Practice

On a yearly basis, the CMHC sends a letter to homeEd specifying the *maximum* rental rates homeEd can charge for the Federal subsidized properties. For the Provincial subsidized properties, no such letter is sent. Instead homeEd conducts market surveys that compare the rental rates of two properties that are in close proximity to the homeEd property being reviewed. homeEd then sets their maximum rates for the Provincial funded properties at the lower end of the rates which is consistent with the agreements' definition of market rent.

As for the setting of its *minimum* rental rates, homeEd's practice is based on internal management decisions, and in particular budgeting decisions that support homeEd's break even objective.

Both the maximum and minimum rates set by homeEd management are subsequently approved by homeEd's Board. Further, management discloses its maximum rental rates in the Project Data Reports (PDR) that are submitted annually to CMHC for each property.

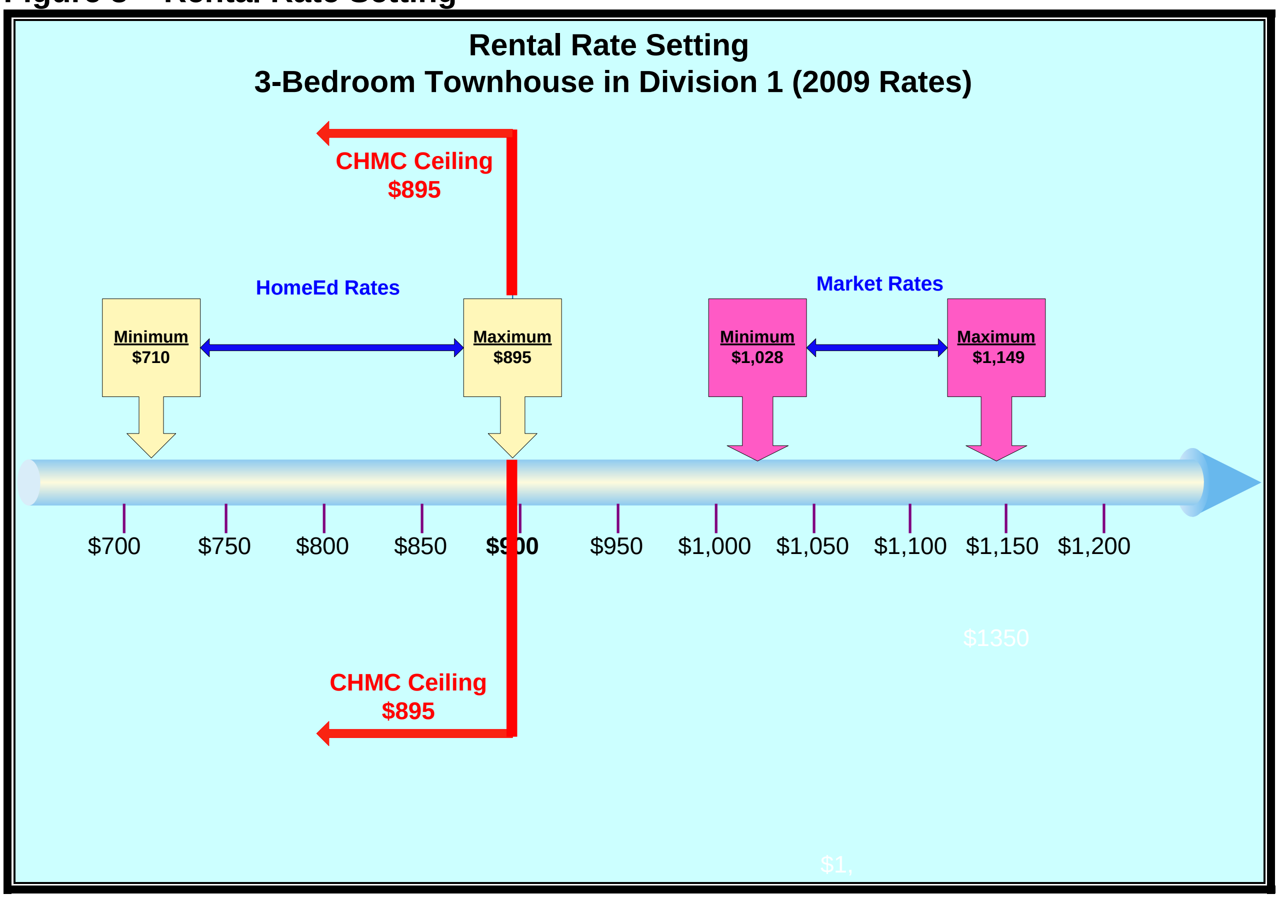
Observations
We observed that the setting of the maximum rental rates was in compliance with the agreements except for one provincial property where the rental rate was greater than the Lower End of Market (LEM). However, since homeEd does not receive formal guidance from the Province (i.e. AHMC) to establish maximum rates for the Provincial properties, we cannot conclude on the impact of this practice.

For the setting of minimum rental rates, section 2(3) of the agreements state that the Provincial Agency would provide homeEd with annual guidance to establish minimum rental rates. However, homeEd has never received such guidance and instead develops the minimum rental rates based on budget needs.

Figure 3 illustrates the concept of rental rate setting for a selected Division 1 property included in our review. The following figure illustrates:

- The minimum and maximum rates set by homeEd.
- The maximum rates as provided by the CMHC (i.e. LEM rates); and
- The Market rates (High to Low) based on the surveys conducted by homeEd's resident managers.

**Figure 3 – Rental Rate Setting**



As shown in Figure 3, the Lower End of Market set by CMHC for this particular property was $895. Accordingly, homeEd's maximum rental rate for this property is $895. The minimum rate set for this property by homeEd is $710. The market survey completed by the resident manager for this particular property shows a rental range of $1,028 - $1,149 for similar properties in the area.

We reviewed documentation (schedules and LEM letters) confirming homeEd's practices to set maximum and minimum rental rates for their Division 1 properties. However, these practices are not documented in formal policy or procedures.

We observed that management prepares a yearly rental rate schedule which sets out the range of minimum to maximum range rental rates that can be charged for each unit in each property. This schedule is prepared by the Senior Property Manager as part of the budgeting process and is used to forecast the potential range of revenues that homeEd will collect from rental charges for a particular year. Many factors are considered when preparing this schedule including the sustainability of the organization (i.e. operating on a break even basis), compliance to the agreements, and consideration as to whether or not tenants can afford to pay the rent. We observed that the rental rate schedule is subsequently reviewed by the General Manager and ultimately approved by the Board of Directors.

We observed that the Project Data Reports submitted to CMHC for each property do disclose the maximum rent for each property. However, the minimum rents for each property are not disclosed. Thus, without a documented approval for setting minimum rents in the form of an amendment to the current agreements, the current practice to set minimum rental rates by homeEd are not consistent with the terms of the agreement.

Conclusion and Recommendation

The setting of the rental rate range is critical to homeEd's viability. Therefore, as part of recommendation 3 we recommend that homeEd formalize the practices used to set minimum and maximum rental rates into documented policies and procedures. Our 2nd recommendation is intended to help homeEd clarify CHMC/AHMC expectations and to set minimum rental rates through amendments to the Division 1 agreements. This would ensure that homeEd's practice to set minimum rent is consistent with the agreements.

### 4.2.4 Div. 1 - Calculation of Individual Tenant Rental Rates

The rent payable by all tenants in Division 1 units is to be calculated based on their income. homeEd should ensure that this calculation is in accordance with the operating agreements.

Current Practice

homeEd's practice to calculate rent occurs in the following manner:

1. Tenants who submit income verification have their rent determined based on a Rent Geared to Income (RGI)[4] factor of 27%.
2. At the minimum, based on an internal practice, tenants pay the greater of 27% of their income in rent (up to the maximum rental rate) or the minimum rental rate established by homeEd (see discussion in *Section 4.2.3*).
3. Based on budget requirements, tenants will be charged a rental rate that falls within the minimum and maximum rental range for that unit.
4. Tenants who do not submit income verification are automatically charged the maximum rental rate.

Management believes their practices are appropriate based on the annual disclosure to CMHC/AHMC and that any issues raised by CMHC/AHMC are resolved by management. These disclosures include:

- The *Annual Project Data Reports* (PDR) which disclose actual revenues and expenses generated for each property as well as the tenant profile for each property (i.e. household size, unit types, and gross household incomes).
- Budgets containing individual line items for estimated income and expenses for the applicable property.
- The annual audited financial statements that assess the fairness of the financial information presented by homeEd in its financial statements. These statements are audited by homeEd's external auditors.

Observations

1. Graduated Rent-to-Income (RGI) scale

The Division 1 agreements require rental rates to be calculated using a graduated *Rent-to-Income Scale.* An example of this scale was provided in Schedule A of the agreements. If homeEd was using this scale, rent would be determined using RGI factors that range from 16.7% to a maximum of 30%[5]. This means that a tenant at the lowest income range would pay only 16.7% of their income in rent while a tenant at the highest income range would pay 30% of their income in rent.

Currently however, homeEd calculates a tenant's rent by using a flat rate of 27% instead of the graduated rent-to-income scale. Additionally, the minimum a tenant will pay is based on homeEd's internal practice where a tenant pays the greater of 27% of their income (up to maximum rent) or the established minimum rental rate set by homeEd.

Figure 4 on the following page illustrates the impact of the above discussion.

[4] The Rent-Geared-To-Income Factor is a percentage that is used to determine the portion of a tenant's income that should be paid in rent.

[5] In 1992, the Ministry of Municipal Affairs issued a letter to homeEd increasing the RGI scale to a maximum of 30% from 25%, as originally stated in the agreements. The letter also referenced *Schedule A*, indicating that homeEd is to calculate rent in accordance with *Schedule A.*

### Figure 4 – Calculation of Rental Rates

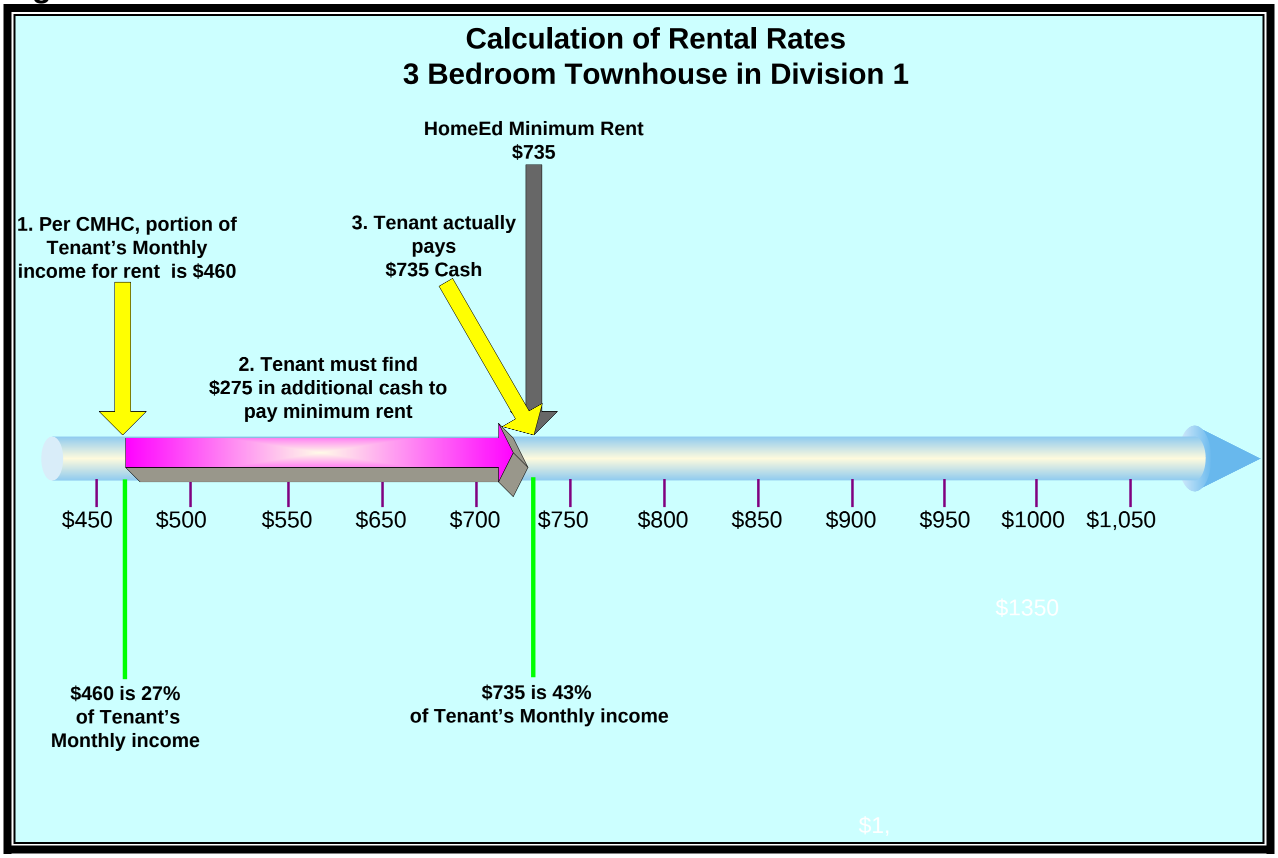



Figure 4 illustrates the rental rate calculation from one of our selected samples. The tenant's monthly income was $1,704. homeEd calculated rent based on the greater of 27% (i.e. $1,704 * 27% = $460) or minimum rent (i.e. $735). In this example, the tenant paid $735 in rent. This amount is equivalent to 43% of the tenant's income. This is beyond 27% and in fact beyond the 30% permissible by the CMHC/AHMC. In our testing of 26 Division 1 samples, we found 14 instances (54%) where a tenant's cash outlay was greater than 30% of their income.

Consequently, two issues result from using the greater of 27% of income versus minimum rent and not using the prescribed rent to income scale:

1) Tenants can potentially pay more than 30% of their income in rent, which is above the threshold established by the CMHC/AHMC.
2) Using a flat rate defeats the blending of income principle[6], as required by the agreements. This principle ensures that tenants with lower incomes benefit by paying lower rents while tenants with relatively higher incomes pay relatively high rents.

[6] The blending of incomes within a project will permit tenants at the lower end of the income range to benefit from the subsidy in excess of the average for the project, while those at the midpoint will receive the average subsidy, and those at the upper end will receive less than the average subsidy.

Management asserts that the annual disclosure of their financial performance to CMHC, and CMHC's subsequent acceptance of that information, is an indication that their practices in calculating rent are acceptable. However, we reviewed the disclosures made by management to the CMHC and observe that the disclosures are high-level financial overviews that do not detail homeEd's rent calculation practices.

While acknowledging management's reporting to CMHC, we conclude that homeEd's current practice to calculate rent is inconsistent with the terms of the agreements, based on the following:

1. The Division 1 agreements require homeEd to use a graduated rental scale concept to determine an individual tenant's rent. homeEd uses a flat rate which means that tenants' rents are not being calculated in accordance with the agreements. Further, this means that rent is not calculated based on the principle of blending incomes for their Division 1 properties.
2. homeEd's practice to charge a tenant the greater of 27% of their income or minimum rent can result in individual tenants paying more in rent than the authorized maximum of 30%.

2. Fixed Rate Rent Supplement Program (Cornerstones Program)

homeEd receives funding through a pilot project under the Cornerstones program of the City of Edmonton, administered by the Capital Region Housing Corporation (CRHC). The purpose of this funding is to assist households in need to obtain rental accommodation in the City of Edmonton at subsidized rents. The subsidy is provided directly from CRHC to homeEd to provide the tenant a reduction in rent. homeEd currently applies this subsidy to tenants residing in Division 1 properties.

The agreement states that only households in need will be selected, that the recipient will be selected by homeEd, and that homeEd will subsidize the tenant no more than $200[7] per month. homeEd's practices to apply this subsidy is not documented, however management advised that homeEd utilizes this funding to rebalance its revenues.

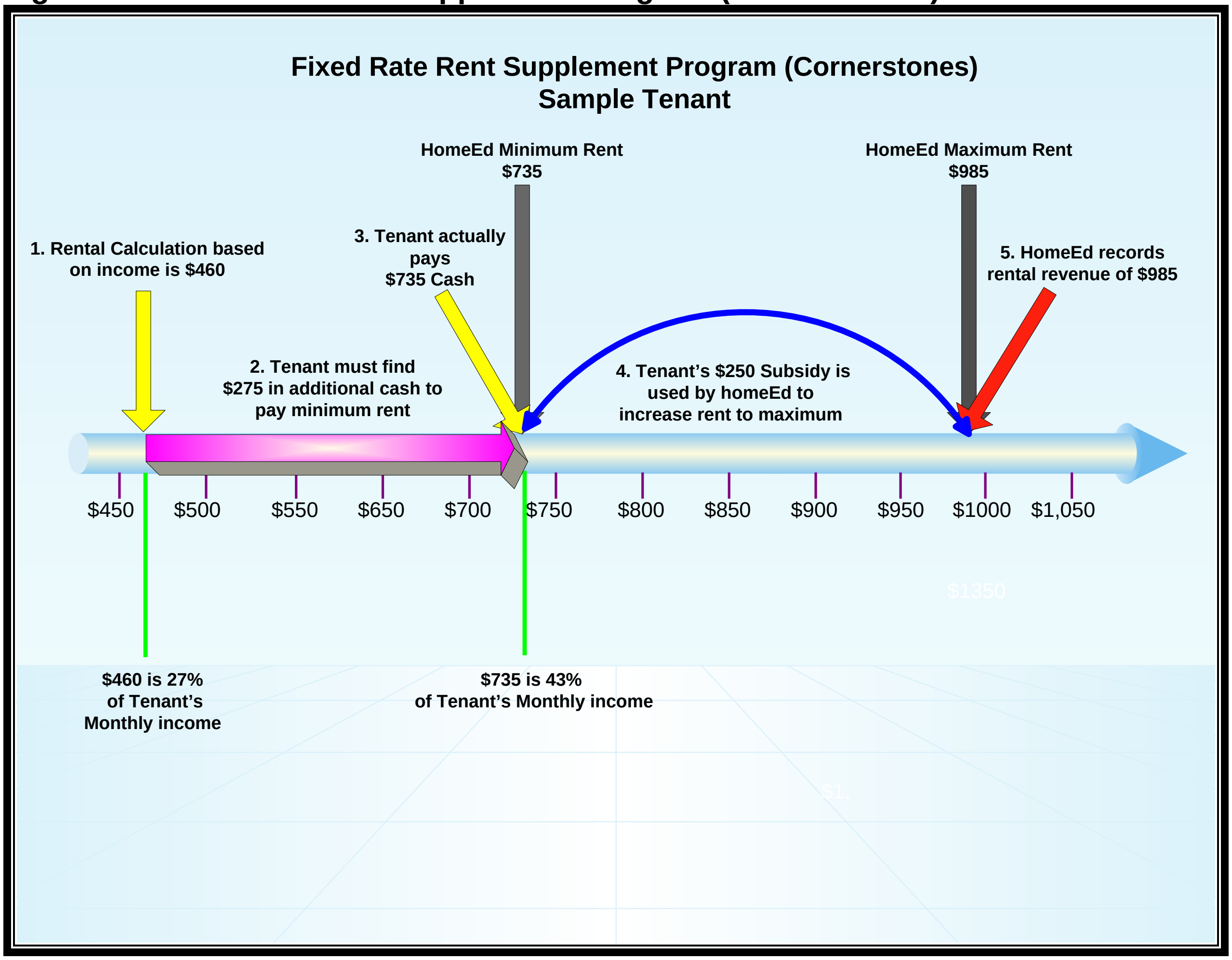
Management evaluates various factors when deciding which units to allocate the subsidy to, including:

- Whether or not a tenant is receiving social assistance,
- Household size relative to their income,
- Any other circumstances that create hardship for the tenant.

Through our sample testing we observed that one way management was applying the subsidy was to simply increase a tenant's rental rate to the maximum rental rate. Continuing on with our example from Figure 4 above, Figure 5 on the following page illustrates one way homeEd applied the Fixed Rate Supplement.

[7] Effective October 2009, the rate increased to $360 per unit.

**Figure 5 – Fixed Rate Rent Supplement Program (Cornerstones)**




As shown in figure 5, the rental revenue recorded for this particular unit is $985. The unit receives a subsidy; however, the subsidy is used to increase the rental rate to $985. homeEd, in turn, recognizes the $250 subsidy, as rental revenue. At the time of testing, we observed 12 Division 1 samples where a unit received a rent supplement as part of this program. In all 12 samples, the rent supplement increased the unit's rent to maximum, but had no direct financial benefit for the tenant.

Based on discussions with management, management's interpretation of the agreement is that it is a direct-to-landlord subsidy, meaning that the subsidy is allocated to the unit and not the tenant. Accordingly, in addition to the practice discussed above, based on budgeting needs, management applies the subsidy in the following ways:

1. Increase cost of the rental unit to minimum – In situations where tenants are receiving government income assistance (i.e. Support for Independence) and cannot afford to pay the minimum rental cost established by homeEd, the subsidy is used to pay the difference between what a tenant can pay and the minimum rental cost of the unit.

2. Move Outs: When tenants move out, depending on the financial needs of homeEd, management may designate the vacant unit as a maximum rental rate unit. Subsequently, if a tenant moves into that unit and cannot afford to pay the maximum rental cost (i.e. based on homeEd's calculation of 27% of their income), the subsidy will be used to bridge the gap between the maximum rental cost of the unit and what the tenant can actually pay.

3. Tenants In-situ: The income of tenants can vary from year to year and as a result there are instances where tenants can no longer afford to pay the maximum rental cost associated with their unit. In such instances, in order to maintain the level of rental revenues, management will allocate a subsidy to the unit equal to the difference between the maximum rental cost and what the tenant can actually pay.

Collectively, the underlying objective of the above practices by management is to ensure that sufficient rental revenues are collected to allow homeEd to break even. Management has noted that adjusting its allocation based on homeEd's need to rebalance revenues is consistent with the intent of the agreement.

Our review of the Fixed Rate Supplement Agreement and homeEd's utilization of these subsidies resulted in a number of observations that require clarification between homeEd and the Capital Region Housing Corporation. While we confirm that the funding is provided directly to homeEd, the agreement states it is paid "on behalf of eligible tenants". It also authorizes homeEd to select the tenant; however the method of determining the individual units should be formally documented. And finally, the lease provided in the agreement clearly states that homeEd is to "provide the tenant a reduction in rent". Our testing confirmed that in some instances, as illustrated in Figure 5, the tenant did not actually receive a reduction in rent.

<u>Conclusion and Recommendations</u>

1. With respect to the RGI scales, homeEd annually reports its rental revenues to CHMC/AHMC and those reports are accepted. However, those reports do not disclose homeEd's practices to calculate rent. We therefore recommend that homeEd formalize their practices through amendments to the current CMHC/AHMC agreements (Recommendation 2). This would then ensure that homeEd is calculating rental rates in accordance with the agreements. Subsequently, we also recommend that homeEd document and formalize their rental calculation practices into policies and procedures (Recommendation 3).

2. Recommendation 2 also applies to the Fixed Rate Rent Supplement funding received from the Capital Region Housing Corporation. homeEd believes they are administering this funding within the intent and spirit of the agreement. Our observations indicate that clarification is required that may result in amendments to the agreement. Once confirmed, we also recommend that homeEd formalize the application of this subsidy (or similar subsidies) into a documented policy and procedure (Recommendation 3).

***Overall Conclusion for Rental Revenues Determination – Division 1***

Two key themes arose with respect to the Revenue Determination process for Division 1 properties. Firstly, much of homeEd's current practices are in support of their objective to break even despite the agreement's emphasis on providing housing for low to moderate income individuals. This is evident in their practices to establish minimum rent, charge maximum rent in the absence of income verification, and in how the Fixed Rate Rent Supplement is applied. Secondly, many of these practices are not documented and should be formalized into documented policies and procedures.

Before formalizing homeEd's practices into policies and procedures, the agreements with its funding partners (CMHC, AHMC, CRHC) should be amended to confirm the spirit and intent of the agreements is being adhered to. We therefore recommend that homeEd work with its funding partners and formalize their current practices into amendments to the current funding agreements. This will then provide assurance that their practices are consistent with the Division 1 property agreements.

## York Street– Rental Rate Determination Process

York Street is a Division 1 property with 20 units that operates with a unique Project Operating Agreement. This agreement requires that York Street units be allocated to households in need[8] (i.e. the agreement is titled: *Assistance to Non-Profit Corporation with the Alberta Mortgage and Housing Corporation (dated 1993)).*

### 4.2.5 York Street – Tenant Eligibility

Current Practice

HomeEd focuses on individuals who are receiving some form of government income assistance for its York Street units. Tenant eligibility is established by reviewing documentation that supports the tenant's reliance on government income assistance. HomeEd also uses the Core Need Income Threshold[9] (CNIT) guideline produced by Alberta's Ministry of Housing and Urban Affairs to ensure that the incomes of potential applicants are below the CNIT thresholds.

Observations

We observed that homeEd uses the agreement for York Street to guide decisions for tenant eligibility. Based on the samples we reviewed, we observed that the tenants: 1)

[8] The agreement defines household in need as: “"Households in need" means those households who cannot afford or cannot obtain adequate and suitable accommodation. This includes those households: (1) who occupy a crowded or inadequate dwelling and who currently pay less than 30% of their income for shelter but for whom basic shelter costs for an adequate and suitable dwelling available in their market area would consume 30% or more of their income; 1i) who pay 30% or more of their income for shelter and for whom an adequate and suitable dwelling available in their market area would consume 30% or more of their income. “

[9] Core Need Income Thresholds (CNITs) assists in distinguishing households requiring social housing assistance. Households with annual incomes equal to or less than CNIT are said to have insufficient income to afford the on-going costs of suitable and adequate rental units in their area. CNITs in a market area are established based on 30% of the Median Market Rent. CNITs are calculated by Canada Mortgage and Housing Corporation (CMHC) in partnership with Alberta Housing and Urban Affairs.

were on government income assistance, and 2) had incomes that were significant below the CNIT guideline, and thus could be defined as meeting the definition of “Household in Need.” Although homeEd uses the agreement to guide decisions, they have not formalized its York Street tenant eligibility process into a documented policy/procedure.

#### 4.2.6 York Street – Annual Income Verification

Current Practice

HomeEd annually sends out letters to tenant’s at York Street to verify their income.

Observations

Section 2 of the York Street agreement requires that the income of tenants residing at York Street be verified annually. We observed that both samples tested for York Street contained evidence of income verification. Again, there is no documented policy/procedure to guide this process.

#### 4.2.7 York Street – Rental Rate Setting

Current Practice

homeEd sets the rental rates for York Street tenants in accordance with the *Social Assistance Rent Schedule* (Schedule B) provided in the agreement.

Observations

For York Street, the agreement stipulates a rental rate of 25% of a tenant’s adjusted family income or individual income. Additionally, tenant’s who are receiving social assistance must have their rents determined in accordance with *Social Assistance Rent Schedule (*Schedule B) provided in the agreement. The tenant samples we tested were receiving social assistance and we confirmed that the rents were set in accordance with schedule B. Again, there is no documented policy/procedure to guide the York Street Rental Rate Setting process.

#### 4.2.8 York Street – Calculation of Tenant Rental Rates

Current Practice

HomeEd calculates a tenant’s rental rates with reference to schedule B in the agreement.

Observations

We observed that homeEd was using schedule B and used it correctly to determine rent for our selected samples since both tenants were receiving some form of government income assistance. Again, there is no documented policy/procedure to guide this process.

***Overall Conclusion for Rental Revenues Determination – York Street***

We observed that practices which support the Rental Revenue Determination process for York Street were consistent with the terms of the agreement. However, similar to Division 1, these practices are not documented nor have they been formalized into any policies and procedures. To ensure that these practices are applied consistently we recommend the formalization of these practices into policies and procedures (Recommendation 3).

## Division 2 – Rental Rate Determination Process

Division 2 properties operate on an affordable housing model or housing for the homeless model. The model depends on the provisions of the funding agreement(s) specific to the property. There are 5 properties in Division 2; however only 3 properties were tested by the OCA (i.e. Fraser, Lexington, and Brightstar) since 2 properties were under construction at the time of our review.

Aside from mandate, a key difference between Division 1 and Division 2 properties is that the agreements are not homogenous and thus each property is subject to a different agreement.

### 4.2.9 Tenant Eligibility

Fraser, Lexington and Brightstar are subject to the *Cornerstones Plan* agreement with the City. Fraser is also subject to the terms of the *Affordable Housing Grant* agreement with the Province. The *Cornerstones Plan* requires that homeEd target and provides housing to individuals earning less than the median income for the household type as published by the City's Housing department. Fraser is also subject to the Affordable Housing Grant agreement with the Province which further states that homeEd should attempt to house Fraser units with individuals who have special needs.

<u>Current practice</u>
When individuals first apply for Fraser, Lexington and Brightstar units, homeEd substantiates their income by reviewing tax returns, pay stubs, and copies of any government income assistance payments that the individual may be receiving.

<u>Observations</u>
We reviewed the terms of the *Cornerstones Plan agreement* which states that tenants living at Fraser, Lexington and Brightstar must:

1. Have incomes that do not exceed the median incomes as published by the City's Housing Department for any given year.
2. Be residents of the City of Edmonton.

Additionally, for Fraser, the Province's *Affordable Housing Grant* also notes that eligible tenants are lower income residents, which may consist of lower income families and persons or households with special needs in high growth communities.

From the samples we reviewed, we observed that the tenants' were eligible to reside in all three properties based on documentation that supported that they were low income (i.e. they were relying on some form of government income assistance). We observed however, that there was no documented policy or procedure to guide homeEd's tenant eligibility process for these properties. This is important to ensure consistency in the application of the agreement terms.

### 4.2.10 Div. 2 – Annual Income Verification

The City's *Cornerstones Plan* and the *Affordable Housing Grant Agreement (i.e.* For Fraser) require that homeEd verify annually the income of tenants residing in Fraser, Lexington, and Brightstar.

<u>Current practice</u>
HomeEd sends out letters to tenants on annual basis requesting that they verify their income.

<u>Observations</u>
Our testing confirmed that the tenants provided adequate evidence to substantiate their annual income (i.e. the period under our review). We note again however, that this practice should be formalized into a policy and procedure in order to ensure that it is consistently applied.

### 4.2.11 Div. 2 – Rental Rate Setting and Calculation of Rental Rates

The Rental Rate Setting process and the calculation of rental rates for Division 2 is simple since the rental rates are clearly stipulated in the agreements and/or letters that are provided annually to homeEd by the grant funders.

<u>Current Practice</u>
homeEd sets rental rates for Fraser in accordance with the rates stated in the *Affordable Housing Grant* agreement since these rates are lower than the rates provided by the City's Housing Branch, which administers the *Cornerstones Plan* agreement. Rents for Lexington and Brightstar are set by the City's Housing Branch in accordance with the rent provisions of the *Cornerstones Plan* agreement.

<u>Observations</u>
As noted earlier, Fraser is subject to two agreements:

1. Section 3 of the *Affordable Housing Grant* explicitly states the amount of rent that can be charged for the units.
2. Section 7 of the Cornerstones Plan *requires* that project rents not exceed 85% of CMHC's annually published *Average Market Rent Reports for the City of Edmonton.* Further*,* The City's Housing Branch, which administers the agreement, provides homeEd with these rates noting them as the "maximum" rental rates that can be charged.

From the samples we reviewed, we observed that the rental rates stipulated by the Province were lower when compared to the City's Housing Branch. Our testing confirmed that homeEd set the rates for the Fraser units in accordance with the rates stipulated in the *Affordable Housing Grant* agreement. We also observed that rental rates set for Lexington and Brightstar were either at, or slightly below, the maximum established by the Housing Branch for the *Cornerstones Plan*. Again, we observed that there was no documented policy/procedure to guide the rate setting process for these properties.

***Overall Conclusion for Rental Revenues Determination – Division 2***

Our testing confirmed that homeEd's Rental Revenue Determination practices for Division 2 properties were consistent with the terms of the agreements. However, similar to Division 1 and York Street, these practices are not documented nor have they been formalized into policies and procedures. To ensure that these practices are applied consistently we recommend the formalization of these practices into policies and procedures (Recommendation 3).

## The Revenue Collection and Recording Process

### 4.2.12 homeEd Revenue Collection and Recording

The processes to collect and record rental revenues at homeEd are the same for Division 1, Division 2, and York Street. An effective revenue collection and recording process ensures that revenue is collected and recorded in a timely and accurate manner.

Current Practice:

homeEd's processes to collect and record revenues are summarized below:

1. Resident Managers (RMs) receive rental payments from tenants at the first of each month. Payment can be made by cheque, money order, or cash. Cash payments however must be made directly to head office. Rental payments for tenants on government income assistance, from trustees, and/or other agencies are sent directly to head office. These cheques are then forwarded back to the RMs for recording purposes.
2. Upon receipt of payment, the RMs will issue cash receipts to the tenants and update their tenant ledgers for the payments received and as well as any other charges (e.g. late fees).
3. The RMs deliver the rental payments and copies of the cash receipts to head office.
4. The Property Manager reviews all payments and flags any payments which may have errors (e.g. No signature, wrong date, etc.) and notifies the RMs to obtain the correct payment.
5. The Property manager batches the cash receipts in sequential order and sends the batches to the City (i.e. the Remittance Processing Area) for processing.
6. The Payments are deposited in homeEd's account through Cash Clearing and are automatically applied to the Accounts Receivable General Ledger and the Tenants' Sub Ledgers.
7. Any returned cheques are sent to Head Office from the City Accountant. The property manager reviews and records these cheques and contacts the RMs to collect payment from these Tenants. Tenants who fail to pay outstanding monies by the 8th of each month are charged late fees and begin to receive written correspondence from head office advising of payment.
8. If the tenant fails to contact the RM and/or respond to the office correspondence, their files are sent to a collections agency. If payment is still not received, the tenant is given a notice to evict.

Observation

We reviewed the documented procedures for the collection of monthly rent from tenants as well as the recording procedures in place. The process in place does allow for proper segregation in the collection and recording of tenant rent payments. We tested 34 samples and in all instances the rental collection followed the procedures and the rental payments were properly recorded.

We also tested the reasonability of rental revenue by recalculating the amount of rent to be collected for the 2009 year. Our estimation was comparable to homeEd's budget and to the actual rent collected in 2009.

Approximately 13% of revenues relate to operating grants, we confirmed the amount received by homeEd in 2009 through the grant letters from CMHC and the Province. These amounts approximated the operating grant budget for 2009. The operating grant budget was calculated in accordance with the methodology in the operating agreements. Thus, no significant issues were noted.

A variance analysis comparing the 2009 budget and the 2009 actual was completed. We observed no significant variances.

Conclusion and Recommendation

We did not observe any issues with the processes and procedures in place relating to the collection and recording of revenues.

## 4.3. Expenses

The agreements require that homeEd maintain the project in a satisfactory state of repair and fitness for occupancy. The agreements also require that homeEd operate on a break even basis. Thus, good internal controls over expenses will support homeEd's effort to effectively manage its expenses.

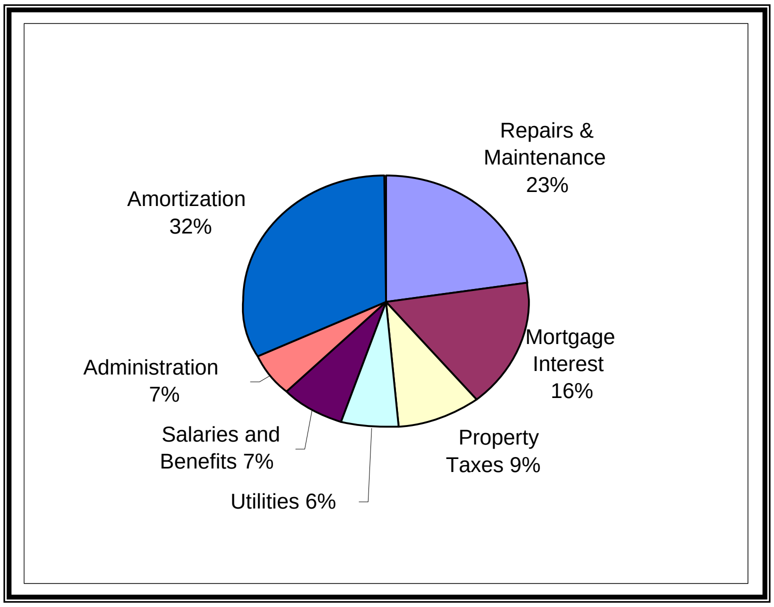
homeEd's major expenses can be categorized into three main groups:

1. Repairs and Maintenance (R&M) expenditures that ensure that the apartments and townhomes remain in a satisfactory state for occupancy. These can include periodic expenditures such as painting of suite interiors and capital expenditures such as roof replacements.
2. Other Expenses – which include Amortization, Administration, Mortgage Interest, Property Tax, and Utility expenses.
3. Salaries and Benefits.

For the past 3 years R&M expenses have accounted for approximately 23% of homeEd's total expenses on average. While stable as a proportion of costs, these expenditures have increased from $803,000 in 2007 to $1.487M in 2009. This increase is due to planned expenditures for major refurbishment of two older apartment buildings acquired in 2008 and 2009.

We focused our expense testing on homeEd's R&M costs. Figure 6 shows the average proportion of homeEd's expenses.

**Figure 6**
**HomeEd's Expense Proportions (Average of 2007 – 2009)**




Our objective was to review the validity and reasonability of homeEd's expenses. We achieved this by reviewing and assessing the adequacy of the controls used to support homeEd's expenditure process. In particular, we assessed the following controls:

- **Approval of Expenses** - all expenses incurred should be properly approved.
- **Review and Recording Controls** – procedures should be in place to ensure that all expenses were properly reviewed, and recorded in the financial system.
- **Tendering Controls** – policy and procedures should be in place to ensure that major capital projects are tendered and documentation exists to evaluate vendors.

We also reviewed the reasonability of Salary and Benefits expenditures and assessed whether or not appropriate procedures were in place to ensure that salary and benefit amounts were approved and properly recorded.

### 4.3.1. Overview of HomeEd's Expenditure Process

Current Practice

homeEd's expenditure process is the same for both Divisions and is detailed in homeEd's *Internal Control Summary.* The Summary discusses homeEd's methodology for approving, reviewing, and recording expenses. Below is a chronological summary of homeEd's expenditure process:

1. R&M expenses are initiated by resident managers whenever maintenance work is required (i.e. subject to approval limits discussed in section 4.3.2).
2. Once the work is completed, the vendor sends the invoice to the resident manager who reviews it and compares it to the work that was actually performed by the vendor. If no issues are identified the resident manager sends the invoice to head office for processing.
3. Invoices for Other expenses, such as marketing and offices supplies are also sent directly to head office by the vendors.
4. Collectively, all of the invoices are reviewed and processed into batches by Head Office.
5. These batches are then sent to the City's Finance department who processes payments to homeEd's vendors.

Observations

We tested 19 R&M samples and 12 Other Expenses samples and did not observe any exceptions to this process.

### 4.3.2. Approval of Expenses

The approval of expenditures in accordance with internal procedures is an important component of the expenditure process as it ensures that expenses are authorized and thus valid. Our review consisted of assessing the approval of invoices as well as the approval for purchase orders.

Current Practice

According to the client's internal control procedures, the Senior Property Manager has the authority to approve expenses below $5,000. Expenses greater than $5,000 must be approved by Senior Management. Additionally, purchase orders (P.O.'s) greater than $500 must be approved and authorized by the senior property manager before R&M work can begin.

Observations

*Invoice Approval*

In our review of expenditure items for homeEd, our criteria were to ensure that all expenditures were properly approved prior to disbursement. Our testing of 19 R&M samples showed that:

- 14/19 invoice samples were under $5,000 and the Senior Property Manager approved these invoices.
- 5/19 invoice samples were over $5,000 and there was no indication on the invoice of senior management approval.

- 3 of these invoices related to Division 2 and contained line items that were greater than $5,000.

Subsequent to our review senior management made us aware of a procedure that permits the Senior Property Manager to approve all individual expense amounts up to the amount of the approved budget relating to the specified project. (For example, a capital budget of $100,000 approved by senior management would provide the senior property manager with the authority to approve individual expense amounts that were greater than $5,000). Thus, senior management justified the absence of approval on the 3 invoices we identified as not being approved, since the charges were part of an overall capital budget that was previously approved by senior management. However, we were not made aware of this procedure at the time of our review nor was there any documentation to support this procedure until recently, in August 2010, subsequent to our review. Accordingly, at the time of the audit, these expenditures were not properly approved.

For the two samples in Division 1 that we identified as not being approved, we observed that these costs did not relate to any capital budget. Instead, it was asserted by management that the expenses were approved either verbally or by email (which we did not receive). We note that without documented approvals for significant expenditures (i.e. greater than $5,000); senior management decreases its ability to properly monitor cash-flows.

*Purchase Order (P.O.) Approval*
In reviewing the internal control summary, we observed that there was no guideline or policy to support the $500 P.O. approval threshold. Nevertheless, the approval of P.O.'s is an important control as it identifies:

- the type of work required,
- the contractor who will carry out the work, and
- the estimated cost.

The P.O. process ensures that work completed by the contractor is work that was requested. As well, estimating the cost of the work order allows comparison to the final invoice which, in turn, enables the senior property manager to assess the reasonability of the charges.

Through our testing of 19 samples, we found the controls around the approval and completion of P.O.s to require improvement. From the 19 samples tested, we deemed the P.O. to be improperly completed in 11 instances. This included 8 P.O.'s where the amount quoted was greater than $500, yet there was no approval by the senior property manager. Other observations related to missing information such as dates and the cost of the job estimate.

Conclusion and Recommendation
An effective approval policy will ensure that cash resources are monitored and are appropriately used. To enhance its current approval process we recommend that

homeEd develop a written policy relating to the approval limits for major expenses (i.e. items greater than $5,000) and purchase orders (Recommendation 3). This policy should also discuss how approvals are to be received and documented.

### 4.3.3. Reviews and Recording

Reviews of expenditures ensure that work is completed and that the amount charged is reasonable and valid. Additionally, proper recording of expenses contribute to the fair representation of expenses in the financial statements. Strong internal reviews and recording controls form an important component of any expenditure process.

Current Practice

As discussed above in section *4.3.1 Expenditure process*, there are three levels of reviews for R&M expenditures:

1) First by the resident managers when he/she compares the charges of the invoice against the actual work performed by the vendor.
2) Second by head office, when they review the invoices sent to them by the resident managers for accuracy. At this stage, invoices received from vendors for *Other Expenses* are also reviewed by head office. If no issues are identified, the invoices are batched and an invoice summary is prepared and sent to the City's Finance and Treasury Department.
3) Thirdly, the City also reviews the invoice summaries and performs monthly spot audits to attest to the validity of the items on the invoice summaries.

In terms of recording, when resident managers receive invoices from vendors, they also code the charges based on General Ledger (G/L) account codes provided to them by head office. At the time of their invoice review (i.e. 2$^{nd}$ level), head office also reviews the G/L coding for accuracy. Other Expenses are coded into G/L accounts by head office. The recording process is completed when the City posts the payments to the financial system (SAP).

Observation

From our selected samples we observed that procedures to review and record expenditures were adequate.

### 4.3.4. Tendering Policies

The nature of homeEd's business requires the use of many vendors for a wide variety of projects. Thus, a process to obtain competitive bids and to evaluate vendors is important to ensure that homeEd is receiving the best value for money when selecting a vendor.

Current practice

*General R&M*

With respect to general repairs and maintenance, there is a listing that contains one vendor for each type (carpentry, plumber, electrical, painting, tile work, flooring, locks and keys, carpet cleaning, etc.) of work required. When repair and maintenance work is required by a resident manager, the resident manager must use this list. Every two years, the senior property manager performs a pricing comparison that compares the rates charged by its vendors to other vendors.

*Major Capital Projects*
For significant R&M work such as large scale renovations and/or capital projects, homeEd's tendering process is as follows:

> *For any large project (as deemed necessary by the Property Manager and Director of Property Management & Leasing) the following applies:*
> 1. *A specification sheet and tendering document is put together by the Property Manager.*
> 2. *The tendering package goes out to the contractors (faxed usually).*
> 3. *The contractors return the packages by an assigned date.*
> 4. *The packages are reviewed by the Property Manager.*
> 5. *A summary of the quotes are reviewed by the Property Manager and the Director of Property Management & Leasing and a contractor is chosen.*
> 6. *Property Manager contacts the contractor.*

<u>Observations</u>
*General R&M*
Through our testing, we observed that homeEd does not document its price comparison practices for its bi-annual assessment of R&M rates offered by its vendors. We also observed that there is no documented process for selecting vendors. Therefore, it is not possible to determine how R&M vendors are selected.

We observed that many of homeEd's R&M vendor's have been with homeEd for a number of years. Although there are benefits to maintaining the same vendor such as familiarity with the process and building of good business relationship, a documented tendering process ensures that all vendors have been selected on a fair and consistent basis.

*Major Capital Projects*
We observed that homeEd's practices to review and select vendors for major capital repair projects (e.g. complete building window replacements, roof replacements, etc.) are not documented. Also, discussions with management confirm that tendering for these large projects are not made publicly available (e.g. Offer to tenders is not advertised in newspapers by homeEd) and instead, depending on the nature and scale of the project, the work is either sole sourced or there is a bid invitation to contractors already known to homeEd. homeEd's current tendering practices need to be documented and could be enhanced by including more information, such as:

- The selection/evaluation criteria,
- Vendor requirements (i.e. insurance),
- Minimum number of vendors to request a proposal form,
- Public tendering versus sole sourcing,
- Dollar limits for contract approval, etc.

As a non-profit organization that receives public funding to support its operations and various initiatives, homeEd must be able to demonstrate that it is receiving the best value-for-money when incurring significant expenditures for capital costs. Documented price comparisons and open and competitive tendering practices are just some ways to achieve this.

Conclusion and Recommendation
We recommend that homeEd publicly tender major capital projects. We also recommend that homeEd document and review its current tendering practices to reflect our suggestions mentioned above. Finally, we recommend that homeEd formalize its pricing comparison method into a documented policy or procedure.

### 4.3.5. Salary Expenses

Current Practice
Annually, the Board of homeEd approves the salary and benefits for staff as part of their overall approval of the budget. The budget is prepared by management and approved by the General Manager prior to the Board's approval.

Observations
Resident managers are paid a salary to manage their respective homeEd property. All resident managers receive the same rate per hour, but the hours associated with each property vary based on factors such as location and complexity of tenants (i.e. turnover/family composition). Additionally, homeEd has agreed in advance to charge minimum rent to all resident managers. In cases where 27% of income exceeds minimum rent, a taxable benefit is incurred. Currently, 3 resident managers receive a taxable benefit.

Head office staff receives annual salaries and their salaries are reflected as management fees in the financial statements.

The City also provides additional resources to homeEd that are accounted for as salary and are allocated to homeEd. This includes a secretary, whose full salary is charged to homeEd as well as an 80% charge to homeEd for an accountant position at the City. Additionally, an estimated $5,000/quarter is also allocated for management consultation which includes the General Manager's position.

We observed that these charges and salaries were properly recorded and classified as salaries and benefits expense on the income statement.

# 5. Conclusion

Our financial review of homeEd assessed the adequacy of controls that support the Revenue and Expenditure processes at homeEd.

The primary observation from our analysis of the *Rental Revenue Determination* process for Division 1 was that the agreements have created competing priorities for management; specifically homeEd is required to operate the properties with the objective to break even and at the same time ensure that individuals with low to moderate income are housed in these properties.

Management has asserted the objective to break even takes priority to operate homeEd in a sustainable manner, on a Not-for-Profit basis, while maximizing the benefits for those in need. Many of homeEd's current practices are in support of the objective to break even despite the agreement's emphasis on providing housing for low to moderate income individuals. This is evident in their practices to establish minimum rent, charge maximum rent in the absence of income verification, and in how the Fixed Rate Supplement is applied.

We observed that many of these practices are inconsistent with the current agreements. In the absence of documented approval for these practices in the form of amended agreements with its grant providers, we cannot provide assurance that these practices are consistent with the terms of the agreement.

We also observed that homeEd's practices to determine rental rates for Division 1 and Division 2 need to be formalized into written policies and procedures. Doing so would standardize homeEd's current practices and more importantly provide homeEd with a documented basis to justify its rental rate decisions.

In terms of expenses, we observed that homeEd's procedure to approve expenses and purchase orders was not always applied consistently and thus we found a few instances of expenditures that were not appropriately approved. While management has created a procedure to approve capital expenditures that are the result of pre-approved capital budgets, we believe that the development and establishment of a separate and comprehensive approval policy will assist management in their attempt to monitor cash-flows effectively.

Finally, we observed opportunities to enhance homeEd's tendering practices for its major capital projects to ensure that homeEd is receiving the best value-for-money when incurring significant expenditures for capital costs.

To address our observations, we have directed three recommendations to homeEd management. By addressing these areas, homeEd's operating practices can be affirmed and its Board and funding partners will be assured that its objectives can be achieved.

We would like to thank both homeEd's and the City's staff members who participated in this review for their cooperation and assistance.

# 6. Recommendations

**Recommendation 1**

The OCA recommends that the GM of the City of Edmonton Non-Profit Housing (NPH) Corporation obtain clarification from the NPH Board on the meaning of "housing accommodation of all kinds" to guide the NPH's decision making processes. Specifically, this includes:

- In Division 1, clarifying which priority takes precedence, break even vs. giving priority to low to moderate income tenants
- In Division 2, clarifying the purpose of affordable housing, particularly, whether homeEd should be servicing income challenged tenants, lower income tenants, homeless tenants, or tenants on government assistance.

**Management Response and Action Plan**

Management (General Manager) Response:

*Support in principle. It is the view of the GM that the NPH Board understands that for Division 1 Properties priority must given to achieving a break even sustainable operating position while seeking to maximize the opportunity to house persons of low and moderate income. This is reflected in the minimum and market rents, and the target ratio of market to non-market tenants approved annually by the Board. With respect to Division 2 Properties, the Board has given specific direction to the GM to look at opportunities to expand the portfolio and the Board has been informed of the GM's proposals for expansion. The Board is aware of the specific housing purpose of the funding programs enabling the expansion and has approved specific motions authorizing the GM to proceed with construction or acquisition of existing housing stock. All funding agreements require the signature of two officers of the Board.*

*The GM recognizes that from a 'best practice' perspective it is beneficial to have the Board adopt an overarching housing mandate policy that broadly defines the range of clients to be served by the NPH, with a sufficient degree of flexibility to accommodate the specific client(s) focus of various government housing assistance programs.*

Action Plan:

*The GM will work proactively with the NPH Board to frame a broad housing mandate policy with flexibility to accommodate the specific client(s) focus of various government housing assistance programs.*

Planned Implementation Date: By June 30/2011

Responsible Party: GM and NPH Board

**Recommendation 2**

The OCA recommends that the GM of the City of Edmonton Non-Profit Housing Corporation review current processes and procedures to ensure alignment to signed operating agreements. Where current processes are not aligned, clarification and/or amendments to the operating agreements should be in place to ensure that homeEd is not in breach of the agreements. These areas include:

- Procedures in place to calculate a tenant's rental rate.
- Income verification requirement.

**Management Response and Action Plan**

Management (General Manager) Response

Support. It is recognized that there are some areas of the existing agreements that lack clarity and that some provisions have become obsolete given changing market conditions and changes in CMHC and Alberta Municipal Affairs operating procedures and program criteria. In response to these circumstances, NPH has been diligent in submitting all required annual project and portfolio operating data to CMHC and Alberta Municipal Affairs and proactively responding to any identified concerns with program operations. In addition, where NPH has taken advantage of new funding assistance programs, such as the Fixed Rate Rent Supplement Program or the Housing for the Homeless RFP, close communication has been maintained with government officials responsible for these programs to resolve any ambiguities and clarify implementation details. NPH acknowledges that from a legal perspective the evolution of operating practices through this approach may not strictly align with the original provisions of the formal operating agreements. NPH believes that the risk of being found in breach of the agreements is low, but agrees that 'best practice' is to seek formal amendments or memorandums of understanding to ensure existing practices are aligned to the operating agreements.

Action Plan:

The GM will work proactively with CMHC, Alberta Municipal Affairs and other government agencies to seek formal amendments or memorandums of understanding to ensure existing practices are aligned to the various operating agreements which provide housing funding assistance to NPH.

Planned Implementation Date: By end of June/2012

Responsible Party: General Manager

**Recommendation 3**
The OCA recommends that the GM of the City of Edmonton Non-Profit Housing Corporation document its operational policies to provide a framework for operational decision making. A policy should be in place to:

- Set the minimum and maximum rental range for properties.
- Define low to moderate income.
- Define Tenant Eligibility.
- Determine the calculation of a tenant’s rental rate.
- Allocate the Fixed Rate Rent Supplement Program.
- Define the Purchase Order process.
- Define the signing authority $ limits.
- The current tendering policy should be updated.

**Management Response and Action Plan**
Management (General Manager) Response
*Support. Currently NPH staff use a combination of the operational parameters established in existing agreements, operational practices established through communication with CMHC and Alberta Municipal Affairs, procedures approved by the Board and staff initiated procedures under the guidance of senior professionals in the Housing Branch and the Finance Branch.*
*The GM recognizes that from a ‘best practice’ perspective it is appropriate to have a framework of higher level policies to give clear direction and context for these type of operating procedures and others that will be required in future to ensure that NPH fulfills its mandate in a conservative, risk adverse, efficient and consistent manner that ensures long term sustainability and asset protection while continuing to maximize opportunities to meet the housing needs of lower and moderate income households.*
Action Plan:
*The GM will work proactively with the NPH Board and consult with CMHC and Alberta Municipal Affairs to develop a framework of higher level policies to give clear direction and context for operating procedures necessary to ensure that NPH fulfills its mandate and funding agreement obligations in a conservative, risk adverse, efficient and consistent manner that will provide long term sustainability and asset protection while continuing to maximize opportunities to meet housing needs of lower and moderate income households.*

Planned Implementation Date: By end of December/2011.
Responsible Party: GM and NPH Board