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Audit Report Number 2007-FW-1002

TO: Justin R. Ormsby
Director, Office of Public Housing, 6APH

Margarita Maisonet
Director, Department Enforcement Center, CV

FROM:

Frank E. Baca
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Lubbock Housing Authority, Lubbock, Texas, Inappropriately Advanced Federal Funds to Support Its Nonprofit Entities

HIGHLIGHTS

What We Audited and Why

We audited the Lubbock Housing Authority's (Authority) financial relationship with its nonprofits because we found problem indicators when reviewing the Authority's overall operations. Our audit objective was to determine whether the Authority was operating its nonprofits in accordance with U.S. Department of Housing and Urban Development (HUD) requirements and if not, to determine the extent, cause, and impact of any violations.

What We Found

The Authority made \$672,395 in inappropriate advances from its low-rent fund to its two nonprofits because management did not follow HUD's requirements and written instructions. One nonprofit has no assets to repay the \$367,907 advanced

to it. The second nonprofit still owes \$304,488 to the Authority's low-rent program fund and reportedly lacks the resources to repay the amount.

What We Recommend

We recommend that HUD require the Authority to either repay the \$367,907 that it advanced to the first nonprofit or seek forgiveness for it. We further recommend that HUD require the Authority to repay its low-rent fund for the \$304,488 balance due from the second nonprofit. Finally, we recommend that HUD take applicable administrative actions against the appropriate parties.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

We provided a draft to the auditee on November 7, 2006, and requested a response by November 20, 2006. The Authority provided a written response on November 16, 2006, and did not disagree with our finding. The Authority's response detailed steps that the Authority has taken to resolve the \$367,907 in advances it made to one nonprofit, and outlined the Authority's plan to repay \$304,488 in advances it made to a second nonprofit. HUD's Fort Worth Office of Public Housing agreed with the report and stated it would provide management decisions within 120 days.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report.

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BACKGROUND AND OBJECTIVES

The City of Lubbock (City) is the ninth largest city in Texas and the largest city in West Texas. The Lubbock Housing Authority (Authority) was established in 1939 to provide decent, safe, and sanitary housing for families of low to moderate income. The Authority is governed by a seven-member board of commissioners appointed by the mayor for two-year terms. It administers both public housing and Section 8 programs. Its staff works and maintains administrative records and tenant files in its main office at 1708 Avenue G in Lubbock, Texas.

The Authority created two nonprofits—the City of Lubbock Housing Initiative and the Management Development Corporation. These nonprofits are component units of the Authority, and the Authority’s financial statements include the operations of the nonprofits.

- City of Lubbock Housing Initiative (Initiative) – In January 1993, the Authority incorporated this nonprofit public benefit corporation. The Initiative is a 501c(3) nonprofit corporation created to provide additional affordable housing and services to the lower income community by acquiring funds that are not available to the Authority in the normal course of business. The Authority purchased and operated several Resolution Trust Corporation properties through the Initiative. It sold the final property in June 2005. The Initiative is currently only a receivable on the Authority’s general ledger because it has no assets to repay the operating advances the Authority made to it. However, the Authority has not dissolved the Initiative, and it plans to use the nonprofit to operate non-U.S. Department of Housing and Urban Development (HUD)-funded projects in the future.
- Management Development Corporation (Corporation) – In June 2002, the Authority created the Corporation as a nonprofit under the Texas Public Facilities Corporation Act to further the goals and objectives of the Authority by providing market rate housing. Through the Corporation, the Authority built and operates a 184-unit multifamily project called the Preserve at Prairie Point. Greystar Management manages the property for the Authority.

During January 2006, HUD’s Fort Worth Office of Public Housing identified the Authority as a candidate for an Office of Inspector General (OIG) audit. It considered the Authority troubled and placed it under a memorandum of agreement to improve its operations. It also questioned whether the Authority had the capacity to operate its housing programs effectively.

The objective of this audit was to determine whether the Authority was operating its nonprofits in accordance with HUD requirements and if not, to determine the extent, cause, and impact of any violations. This is the second of three audit reports on the Authority’s housing programs.

RESULTS OF AUDIT

Finding: The Authority Inappropriately Advanced Federal Funds to Support Its Nonprofit Entities

The Authority violated its contract with HUD by inappropriately advancing public housing funds to support the operations of its nonprofit entities. As of August 24, 2006, the Authority owed its low-rent program \$672,395 because of improper advances to its nonprofits. The Authority made the advances because its prior management wanted to increase its nonfederal revenues by having the nonprofits purchase and operate properties. In making the advances, prior Authority management did not follow HUD's requirements and written instructions. As a result, the Authority had fewer funds available to serve its low-income residents, and the Authority's operations and HUD's funds are at risk.

The Authority Created Two Nonprofits and Made Improper Advances of Federal Funds to Them

To increase its revenue stream, The Authority created two nonprofits—the Initiative and the Corporation. The nonprofits are wholly owned subsidiaries of the Authority, and the Authority created them so that it would not have to be as reliant on HUD for funding. HUD allows housing authorities to operate nonprofits as long as HUD's projects and funds are not encumbered¹ or used to operate the nonprofit entities.² However, the Authority's nonprofits were never self-sufficient. Therefore, the Authority improperly advanced federal funds to the Initiative and the Corporation to cover their operations.

The Authority made indirect advances of federal funds from the low-rent account to the Initiative because the Authority used its low-rent account as a general fund which included the Initiative's operations. HUD allows authorities to use a general fund as an operating account. However, the Authority's annual contributions contract with HUD prohibited the Authority from allowing its nonprofits to withdraw more from the fund than they had on deposit.³ Since the Initiative was not profitable, the Authority deposited less in rents from Initiative properties than it

¹ Section 7 of the annual contributions contract prohibits the Authority from encumbering any project subject to the contract without HUD's prior approval and prohibits the Authority from pledging any project assets subject to the contract as collateral for a loan.

² Section 9, paragraphs (B) and (C), of the annual contributions contract prohibit the Authority from using funds subject to the contract for any purpose other than for contract operations or any other purpose not specifically approved by HUD.

³ Section 10, paragraph (C), of the annual contributions contract prohibits the Authority from withdrawing funds from the general fund for a project in excess of the funds that the project has on deposit in the general fund.

spent in expenses for the Initiative's operations, which caused advances from the Authority's low-rent program to be accrued. The Authority sold the Initiative's properties and used part of the proceeds to repay its low-rent program for some of the advances. However, rather than repaying its low-rent program, the Authority loaned \$310,000 of the proceeds to the Corporation to purchase the land on which the Corporation's sole asset, a 184-unit market rent apartment complex, the Preserve at Prairie Pointe, was built.

HUD Tried to Help the Authority

HUD recognized that the Authority was experiencing difficulties and declared the Authority to be troubled based on poor Public Housing Assessment System scores for the period ending September 30, 2003. HUD hired Quadel Consulting, Inc. (Quadel), to perform an independent assessment of the Authority's operations. Quadel's final report, issued in October 2004, indicated that the Authority was financially troubled, partially due to the purchase of the Corporation's land and to interfund borrowing by the Initiative. The Quadel report prompted HUD to draft a memorandum of agreement with the Authority to improve the Authority's operations. In the memorandum, HUD told the Authority that it would have to repay the funds that it improperly advanced to the nonprofits.

The Prior Executive Director Ignored HUD's Instructions

Despite HUD's instructions to the Authority to cease making advances to the nonprofits, the Authority continued to make indirect advances to the Initiative through its general fund during 2005. In a letter, dated January 31, 2005, HUD warned the Authority against using low-rent funds to pay for its nonprofit activities. On that date, the Initiative owed the low-rent account \$625,447. The Authority continued to advance funds to cover the operating losses of the Initiative, and by May 5, 2005, the nonprofit owed the low-rent fund \$690,996. On May 4, 2005, HUD sent the Authority a second letter reminding it that it could not use low-rent funds to pay for its nonprofit activities. The Authority immediately transferred \$170,000 from the Initiative's account to the low-rent fund and reduced the balance to \$520,996. However, the Authority again began advancing funds from the low-rent account to the Initiative to cover its operating losses, and on June 1, 2005, it owed the low-rent account \$550,926. The Authority sold the remaining Initiative property in June 2005, which stopped the recurring advances. Since June 2005, the Authority has made some transfers from the Initiative's account to the low-rent fund and, as of August 24, 2006, had reduced the outstanding balance to \$367,907.

The prior executive director apparently made these advances without the board of commissioners' approval. A review of the meeting minutes for 2004 and 2005 showed no indication that the board members were aware of HUD's warning letters or of the Authority's continued advances to the Initiative.

The Authority and Its Current Executive Director Are Working to Correct the Problems

The Authority and its current executive director are working with the Fort Worth Office of Public Housing to correct the problems identified in this report. The Authority has made staffing and operational changes during the past year. The board of commissioners terminated the prior executive director's employment in November 2005. The City loaned the Authority one of its city managers for two years to be the executive director. Under the current executive director's leadership, the Authority has removed or accepted the resignation of the director of finance, the Section 8 administrator, and the public housing administrator. The current executive director agreed that the transfers were improper. He indicated that he is seeking HUD's forgiveness for the Initiative's debt, valued at \$367,907 as of August 24, 2006, and intends to sell the Corporation's asset and repay the \$304,488 that the Corporation owed to the low-rent fund as of August 24, 2006.

Recommendations

We recommend that the director of the Fort Worth Office of Public Housing

- 1A. Refer the Authority's actions to the HUD Headquarters Office of Public Housing for a determination as to whether the Authority has committed a significant violation of its annual contributions contract.
- 1B. Require the Authority to either repay or seek the HUD Headquarters Office of Public Housing's forgiveness of the \$367,907 improperly advanced to the Initiative from the Authority's low-rent fund.
- 1C. Require the Authority to repay the low-rent fund the \$304,488 improperly advanced to the Corporation.

Further, we recommend that the director of the Departmental Enforcement Center

- 1D. Implement applicable administrative actions against the appropriate Authority parties.

SCOPE AND METHODOLOGY

We conducted our audit from March through October 2006 at the Authority, the Fort Worth Office of Public Housing, and our office in Houston, Texas. Our audit period was from January 1, 2004, through December 31, 2005. We expanded the scope as necessary to review those nonprofit transactions that were outside the audit period. During the audit, we performed the following steps:

- Reviewed background information and the criteria that control the Authority and its operations.
- Reviewed various reports, databases, and documents to determine existing conditions at the Authority. The data included the independent public accountant's report for fiscal year 2004, the prior OIG audit report (98-FW-206-1001) and audit resolution information, and monitoring reports maintained by Fort Worth Office of Public Housing.
- Reviewed data in the Authority's accounting and operating systems, including the general ledger, check register, and tenant lists.
- Reviewed the Authority's relationships with its nonprofits to determine whether the Authority was inappropriately supporting the nonprofit operations with federal funds.
- Conducted interviews with Authority staff, the independent public accountant, and Fort Worth Office of Public Housing personnel tasked with oversight of the Authority's operations.

We performed our audit in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined the following internal controls were relevant to our audit objectives:

- Compliance with laws and regulations – policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weakness

Based on our review, we believe the following item is a significant weakness:

- The Authority did not have effective policies, procedures, or controls to reasonably ensure that its federal resource use was consistent with laws and regulations.

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Ineligible <u>1/</u>
1A	\$367,907
1B	\$304,488

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local policies or regulations.

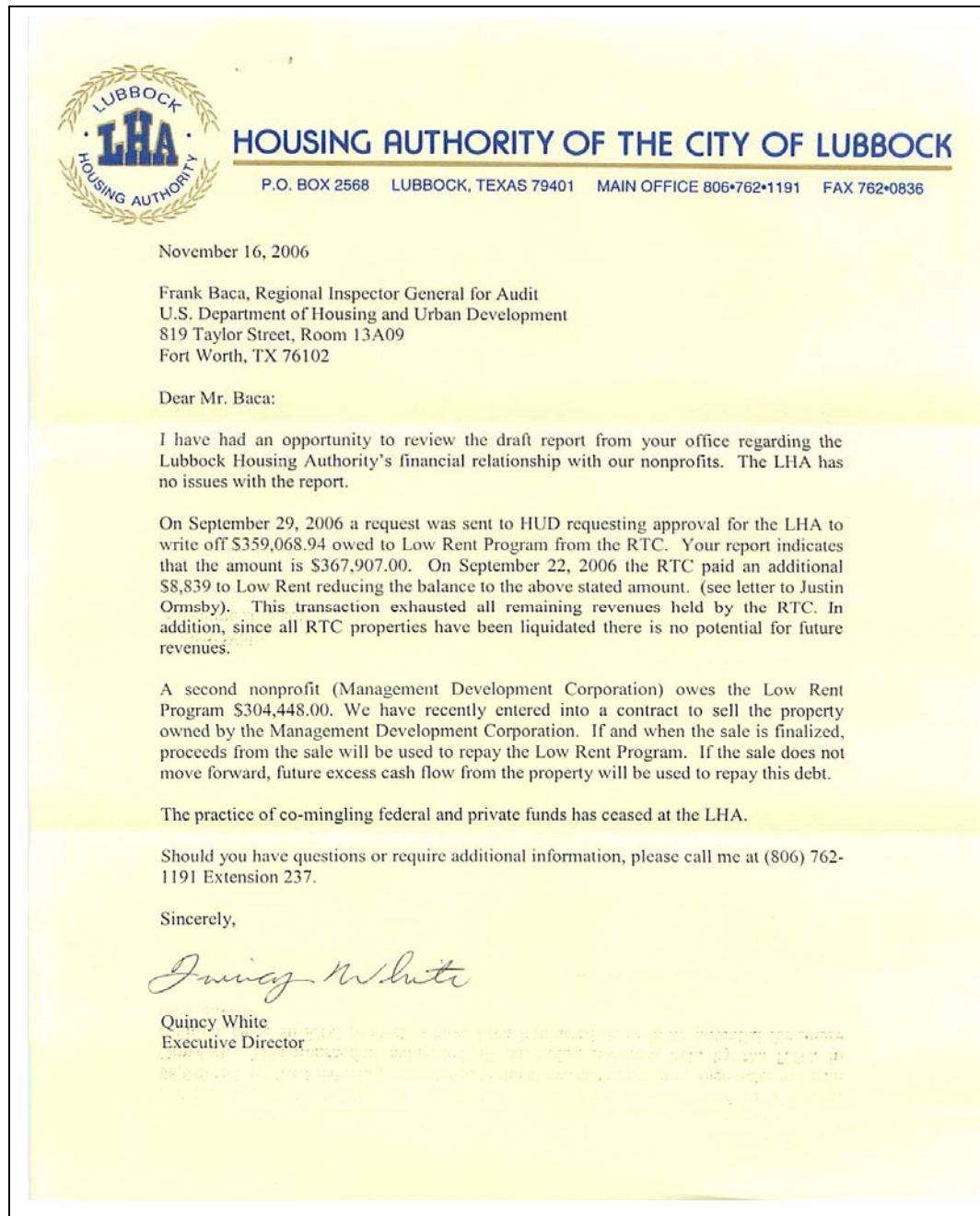
Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Comment 1





HOUSING AUTHORITY OF THE CITY OF LUBBOCK

P.O. BOX 2568 LUBBOCK, TEXAS 79401 MAIN OFFICE 806•762•1191 FAX 762•0836

September 29, 2006

Justin Ormsby, Director
Housing and Urban Development
Burnett Plaza
801 Cherry Street
Fort Worth, Texas 76102

The Lubbock Housing Authority is requesting HUD authorization to write off \$359,068.94 owed to the Low Rent program from the RTC. The last of the RTC properties was sold in 2005 and obviously did not net enough proceeds to pay back all the "Due To's".

On April 20, 2006 the balance owed Low Rent was \$455,907.94. On that date the RTC made a payment in the amount of \$88,000.00 toward the "Due To". On September 22, 2006 an additional \$8,839.00 was paid by RTC to Low Rent resulting in the remaining balance of \$359,068.94.

The RTC has liquidated all assets and has no future revenue streams to pay the remaining "Due To". I see no other option than to request this write-off.

If you have questions or need additional information, please call me at (806) 762-1109 Extension 237.

Sincerely,

A handwritten signature in cursive script that reads "Quincy White".

Quincy White
Executive Director

OIG Evaluation of Auditee Comments

Comment 1 The Authority did not disagree with our finding. Their response detailed the steps they will take and are taking to address the deficiencies.