



Issue Date December 13, 2005

Audit Report Number 2006-FW-1002

TO: Dan Rodriguez
Program Center Coordinator, Office of Public Housing, 6EPH

FROM: 
Frank E. Baca
Regional Inspector General for Audit, 6AGA

SUBJECT: Baytown Housing Authority, Baytown, Texas, Improperly Advanced,
Transferred, and Encumbered Its Public Housing Funds

HIGHLIGHTS

What We Audited and Why

Due to concerns expressed by your office, we audited Baytown Housing Authority (Authority). Our objectives were to determine whether the Authority (1) advanced, transferred, or encumbered resources subject to the annual contributions contract (contract) to the benefit of other entities without U.S. Department of Housing and Urban Development (HUD) approval and (2) equitably distributed salary costs between the Authority's HUD and non-HUD activities in accordance with federal requirements.

What We Found

The Authority violated its contract with HUD by inappropriately advancing, transferring, and encumbering public housing funds to support its nonprofit and related entities. For some of the transfers, the Authority's executive director knowingly altered transfer documentation. As of March 31, 2005, the Authority owed the low-rent and Section 8 programs \$792,360, and it could not support an additional \$134,831 in transfers and encumbrances. The improper conveyances occurred because the Authority ignored its contract requirements and its board of Commissioners did not establish sufficient controls.

Further, the Authority cannot demonstrate that it equitably distributed salary costs between its HUD and non-HUD activities because it did not support

salary payments with required activity reports or equivalent documentation. The Authority lacked support because its management was not aware of the federal requirements. As a result, the Authority cannot support \$1.1 million in salary costs allocated to its HUD programs from April 2002 to March 2005.

What We Recommend

We recommend that the program center coordinator, Houston Office of Public Housing (HUD), require the Authority to (1) repay its HUD programs at least \$792,360 for improper advances, transfers, and encumbrances; (2) repay or provide support for \$134,831 in transfers and encumbrances; (3) repay or provide documentation to support \$1.1 million in salary costs allocated to its HUD programs from April 2002 to March 2005; and (4) implement procedures and controls to correct the weaknesses cited in this report. Proper procedures and controls should help ensure that the Authority puts to better use the \$5,956,761 in HUD funding it will receive next year.

For each recommendation without 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 Authority on November 7, 2005. The Authority's comments were due when the exit conference was held on November 28, 2005. At the exit conference, the Executive Director verbally asked for an extension and we provided one until December 9, 2005. At the exit and in its request for a second extension, the Authority's Executive Director stated he disagreed with the conclusions in the audit. The Executive Director refused to discuss the report and findings at the exit conference. On December 9, 2005, the Executive Director asked for additional time to respond, in addition to the extension already granted, and indicated he would be meeting with the fee accountant in January 2006 to develop a response. We declined the extension request because we had previously informed the Authority in writing that we would issue our report if we did not receive written comments on December 9, 2005. The complete text of the Authority's response can be found in Appendix B of this report.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: The Authority Improperly Conveyed HUD Funds to Its Nonprofit and Related Entities	5
Finding 2: The Authority Did Not Support Its Allocation of Salary Costs	13
Scope and Methodology	15
Internal Controls	16
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	18
B. Auditee Comments and OIG Evaluation	19
C. Criteria	23

BACKGROUND AND OBJECTIVES

The City of Baytown established the Baytown Housing Authority (the Authority) in 1938 under the laws of the State of Texas. Its primary objective is to develop and operate public housing units and provide housing for qualified individuals in compliance with its annual contributions contract (contract) and the rules and regulations prescribed by the U.S. Department of Housing and Urban Development (HUD). The mayor appoints a five-member board of commissioners (board) to govern the Authority. The board hires an executive director to manage the Authority's day-to-day operations. The Authority keeps its records at its central office at 805 W. Nazaro Street, Baytown, Texas.

The Authority manages 150 dwelling units under its low-rent housing program. In fiscal year 2004, the Authority received or spent \$306,803 in operating subsidies and \$442,326 for its Public Housing Capital Fund program. The Authority also administers a Section 8 Housing Choice Voucher program with a total of 727 units and received \$5,251,726 from HUD in fiscal year 2004.

The Authority has one active affiliated nonprofit corporation created in 1982: Baytown Properties Management & Development Corporation (Baytown Properties). Baytown Properties currently owns one project: Forest View Apartments. The Authority owns two other projects, which are related entities: Sam Houston Courts and Lincoln Courts. The Authority opted these two low-rent housing projects out of its public housing program and converted them to market rent when they became debt free in the late 1970s. Additionally, the Authority administered a Section 8 new construction program for Bay Terrace, a nonrelated project, until December 2004.

We selected the Authority for audit because of concerns expressed by the Houston HUD Office of Public Housing. Our objectives were to determine whether the Authority (1) advanced, transferred, or encumbered resources subject to the contract to the benefit of other entities without HUD approval and 2) equitably distributed salary costs between the Authority's HUD and non-HUD activities in accordance with federal requirements.

RESULTS OF AUDIT

Finding 1: The Authority Improperly Conveyed HUD Funds to Its Nonprofit and Related Entities

The Authority violated its contract with HUD by inappropriately advancing, transferring, and encumbering public housing funds to support the operations of its nonprofit and related entities. As of March 31, 2005, the Authority owed its low-rent and Section 8 programs as much as \$927,191 because of the ineligible or unsupported conveyances and encumbrances. Further, the executive director knowingly altered transfer documentation. This occurred because the Authority ignored its contract requirements and its board did not establish sufficient controls. As a result, the Authority had fewer funds available to serve its low-income residents, and Authority operations and HUD funds are at risk.

Inappropriate Advances of Public Housing Funds

The Authority violated its contract with HUD by inappropriately advancing more than \$2 million in public housing funds to pay the expenses of its nonprofit's and related entities' activities. The Authority still owes its low-rent Program \$97,360 of the \$2 million.

The Authority's contract allows it to use its general fund to make payment for other activities but only to the extent that those activities have cash on deposit in the general fund.¹ The Authority advanced funds from its HUD-funded low-rent program account to pay the bills for Forest View Apartments, Lincoln Courts, Sam Houston Courts, and Baytown Properties. Rather than have cash on deposit in the general fund, the nonprofit and related entities repaid the HUD-funded advances the following month. However, these entities did not always fully reimburse the low-rent program account the following month because they lacked sufficient funds to operate. As a result, the Authority had outstanding advances every month to its nonprofit and related entities.

From April 2002 to March 2005, the Authority advanced \$2,049,766 to its nonprofit and related entities, and these entities only reimbursed \$1,952,406 of that amount to the Authority. The Authority continued to make advances, even though in January 2004, its independent auditor informed the Authority

¹ Part A, section 10(C), see appendix C.

that it should not advance funds to its non-HUD programs. As of March 31, 2005, the Authority's nonprofit and related entities owed the low-rent program account \$97,360 for the advances.

Advances from April 2002 to March 2005			
Project or entity	Amount low-rent paid for expenses	Amount reimbursed to low-rent	Outstanding amount Mar. 31, 2005
Forest View Apts.	\$1,224,305	\$1,192,171	\$32,134
Sam Houston Courts	260,608	200,900	59,708
Lincoln Courts	257,834	252,396	5,438
Baytown Properties	307,019	306,939	80
Totals	\$2,049,766	\$1,952,406	\$97,360

Inappropriate Transfers of HUD Funds

The Authority made ineligible transfers of HUD funds totaling \$795,000 to its nonprofit or related entities, of which \$300,000 has been repaid, leaving \$495,000 still owed the Authority. Part of these transfers involved the executive director altering records documenting the transfers. Further, unsupported transfers of \$34,846 are due to the Authority unless it can provide evidence to justify the transfers.

The Authority Made \$795,000 in Ineligible Transfers and Knowingly Altered Documentation

The Authority improperly transferred \$795,000 to its nonprofit and related entities. The transfers included \$640,000 from its low-rent program (of which \$200,000 was repaid) and two transfers from its Section 8 Housing Choice Voucher program of \$100,000 (which was repaid) and \$55,000.

Transfer of \$640,000 from the low-rent program. In violation of HUD's Section 8 Housing Choice Voucher program regulations and the Authority's administrative plan,² the Authority transferred \$560,000 to its low-rent program account in March 2002: \$320,000 from its Section 8 administrative fee reserve and \$240,000 from Bay Terrace's Section 8 administrative fee reserve. That same month, the Authority transferred \$640,000 from the low-rent program account to its nonprofit, Baytown Properties.

² 24 CFR [Code of Federal Regulations] 982.153 and 982.155 and The Baytown Housing Authority, Administrative Plan for Section 8 Housing Programs, chapter 1.Q. See appendix C.

The Authority falsely recorded the transfers to and from the low-rent program account in its financial records. According to the bank statements, the transfers occurred in March 2002, when the transfer to the Baytown Properties was made. However, the executive director backdated the transfers in the Authority's books and records. The checks, which he signed, and the entries in the general ledger were recorded as occurring in December 2001, which was before he was hired as the interim executive director in January 2002.

The transfers violated the Section 8 program regulations and the Authority's administrative plan because neither the Authority's board nor HUD approved them. In addition, the Authority did not establish the maximum amount that may be charged against the administrative fee reserves without specific board approval as required by HUD's regulations and the Authority's Section 8 administrative plan.

Baytown Properties repaid the Authority \$200,000 in May 2002.³ Therefore, the Authority needs to repay the remaining amount of \$440,000 to its low-rent program account and/or Section 8 Housing Choice Voucher program.

Loan of \$100,000 from Section 8 program to nonprofit. On April 22, 2005, after we started the audit of the Authority's nonprofit activities, the Authority transferred \$100,000 from its Section 8 Housing Choice Voucher program funds to Baytown Properties to purchase the San Jacinto Methodist Hospital. The Authority plans to convert the hospital into a center for senior citizens. Section 8 program funds must be used for Section 8 program purposes only. Later, the Authority borrowed \$100,000 and repaid the Section 8 program.

Inappropriate transfer of \$55,000 from the Section 8 program. The Authority transferred \$55,000 from its Section 8 Housing Choice Voucher program to Baytown Properties in March 2003. In February 2004, the executive director wrote off the \$55,000 transfer without approval from the board or HUD. Since Section 8 program funds must be used for Section 8 program purposes only, the Authority needs to repay its Section 8 Housing Choice Voucher program \$55,000.

³ See "*Inappropriate Encumbrance of HUD Funds*" below for additional details concerning this \$200,000 repayment.

The Authority Had No Evidence to Support Transfers of \$34,846

The Authority had no evidence to support \$24,846 owed to its nonprofit, nor could it support a \$10,000 transfer to a related entity. These funds need to be repaid to the Authority's low-rent program unless it can provide evidence to justify the transfers.

Incorrectly recorded low-rent program liability of \$24,846. The Authority's general ledgers showed its low-rent program owed Baytown Properties \$24,846 in November 2002. However, the Authority's records do not reflect that a payment of that amount was ever made to the low-rent program account from Baytown Properties or its project, Forest View. The Authority also incorrectly recorded the transaction as an accounts receivable from its low-rent program. Therefore, the Authority needs to repay its low-rent program account \$24,846 unless it can provide evidence showing Baytown Properties or its project transferred \$24,846 to the low-rent program account.

Unsupported transfer of \$10,000 from low-rent program to related entity. The Authority transferred \$10,000 from its low-rent program account to Sam Houston and recorded the transfer as "Reimbursement of Benefits and Salaries" and not as an interprogram accounts receivable/payable. The Authority could not provide supporting documentation for the transfer and needs to repay its low-rent program account \$10,000 unless it can provide supporting documentation to justify the transfer.

Inappropriate Encumbrance of HUD Funds

Without HUD's approval and in violation of its contract,⁴ the Authority inappropriately encumbered \$200,000 of HUD's funds in a certificate of deposit used as collateral for a November 2000 bank loan to purchase Forest View Apartments, a Baytown Properties project. The Authority secured the bank loan with two certificates of deposit, which were both in the Authority's name: one for \$200,000 and another for \$99,985. The Authority's records showed funds for the \$200,000 certificate of deposit came from the low-rent program account. The Authority could not provide documentation showing the source of funds for the \$99,985 certificate of deposit, even though its contract required it to maintain records identifying the source and allocation of federal funds.⁵

⁴ Part A, section 7, see appendix C.

⁵ Part A, section 9(C), see appendix C.

The Authority later extended and modified the loan and also combined the two certificates of deposit into one. As of March 31, 2005, the principal of the certificate of deposit was \$233,492. According to the Authority's executive director, the original principal of the certificates of deposit was reduced annually to correspond to the current outstanding loan balance. The Authority deposited the \$66,493 in principal reductions and the investment income from the certificate of deposit into its nonprofit's bank account rather than its HUD program accounts as required. The Authority improperly used the HUD funds as collateral and deposited HUD funds and investment income into its nonprofit bank account because its board did not establish sufficient controls to monitor the nonprofit and ensure transactions followed federal regulations.

The Authority's records show Baytown Properties repaid the Authority's low-rent program \$200,000 from May to August 2002 to correct the improper encumbrance of the certificate of deposit. The executive director claimed that the funds to repay the \$200,000 came from nonfederal funds: the proceeds of the sale of mortgages. However, shortly before the Authority made repayment, it improperly transferred \$640,000 in low-rent program funds to Baytown Properties in March 2002 (see discussion under transfers section). Also, Baytown Properties commingled advances from the Authority's low-rent and Section 8 program accounts with funds from its other activities. Since Baytown Properties commingled federal and nonfederal funds, the Authority could not provide evidence to show that the nonprofit repaid the certificate of deposit with nonfederal funds. Further, this transfer merely reduced the amount inappropriately transferred from the low-rent program account.⁶ Thus, Baytown Properties still needs to repay the Authority \$200,000 for the certificate of deposit and provide evidence that it used nonfederal funds for the \$99,985 certificate of deposit.

Authority Operations and HUD Funds at Risk

Apart from having fewer funds available to serve its low-income residents, the Authority's improper advances, transfers, and encumbrances put its operations and HUD funds at risk of loss.

According to its financial statement, the nonprofit and related entities are considered component units within the Authority's reporting entity. The component units are reported as if they were part of the Authority because their sole purpose is to work in conjunction with the Authority to provide housing for low- and moderate-income individuals. Part of the criteria for including organizations as component units within the Authority's reporting entity is whether the organization has the potential to impose a financial

⁶ See "*Inappropriate Transfers of HUD Funds*" above, in which the \$640,000 amount of transfers to be repaid was reduced by the \$200,000 transferred to the low-rent program account.

benefit/burden on the Authority or whether there is a fiscal dependency by the organization on the Authority.

The Authority regularly conveyed funds to its nonprofit and related entities because they did not have sufficient funds to operate. The following table shows that just taking into account advances, excluding transfers and encumbrances, the nonprofit and related entities owed the low-rent program account more than they had in their combined bank accounts.

As of March 31, 2005					
	Lincoln Courts	Sam Houston	Forest View	Baytown Properties	Totals
Funds available in bank accounts	554	5,395	3,311	34,673	43,933
Advances owed to low-rent	5,438	59,707	32,134	80	97,360
Insufficient funds	-4,884	-54,313	-28,823	34,593	-53,427

Additionally,

- As of July 31, 2005, Baytown Properties' project, Forest View, was seven months delinquent in paying its mortgage.
- Forest View has a balloon note with a final payment amount of \$298,186 due on June 5, 2006, unless it refinances or modifies it before it matures.
- The Authority's outstanding advances from the low-rent program account to Forest View were steadily increasing over the audit period.

The precarious position of the nonprofit and related entities in turn affects the Authority and related HUD funding. For example, Authority operations showed a \$524,692 net income in fiscal year 2002, a \$60,862 net loss in fiscal year 2003, and a \$287,874 net loss in fiscal year 2004. We question whether the Authority will be able to meet its delinquent and current obligations and repay the \$927,191 questioned in this report. The Authority's board needs to exercise more control over its operations, including implementing more financial and procedural controls. Further, HUD should perform additional monitoring and technical assistance to ensure that the Authority's nonfederal operations do not have a negative impact on its HUD-funded programs.

Conclusion

The Authority violated its contract with HUD when it advanced, transferred, and encumbered public housing funds to support its nonprofit and related entities. The Authority owes its low-rent and Section 8 programs up to \$927,191 for the improper conveyances. This resulted in fewer HUD funds being available to serve the Authority's low-income residents and put Authority operations and HUD funds at risk. The improper conveyances indicate the Authority often ignored HUD's requirements prohibiting the use of HUD funds for non-HUD activities and did not have adequate controls to prevent these violations from occurring.

Recommendations

We recommend that the program center coordinator, Houston Office of Public Housing (HUD), require the Authority to

- 1A. Repay from nonfederal funds \$97,360 or the current amount of advances to the low-rent program for improper advances, and \$495,000 to its Section 8 and low-rent programs for improper transfers made to its nonprofit and related entities.
- 1B. Provide documentation to support \$34,846 transferred to its nonprofit or related entities or repay its public housing program from nonfederal funds.
- 1C. Repay its public housing program from nonfederal sources \$200,000 for a certificate of deposit used to encumber HUD funds, repay its low-rent program from nonfederal sources \$99,985 for a second certificate of deposit unless the Authority can provide evidence that it purchased the certificate of deposit with non-HUD funds, and repay its low-rent program account for any interest income from the certificates of deposit improperly paid to the nonprofit.
- 1D. Transfer ownership of the certificate of deposit to Baytown Properties once the Authority's low-rent program has been repaid.
- 1E. Provide assurance that it will make no further advances, transfers, or encumbrances of HUD funds on behalf of its nonfederal activities without prior HUD approval. HUD should take sanctions against the Authority if the transfers continue.

We also recommend that the program center coordinator, Houston Office of Public Housing (HUD),

- 1F. Take appropriate sanctions against the executive director for altering the books and records of the Authority.
- 1G. Require the Authority's board to exercise control over the Authority's operations, including implementing more financial and procedural controls, which will ensure that the \$5,956,761 the Authority receives from HUD next year will be put to better use.
- 1H. Perform additional monitoring and provide technical assistance to the Authority to ensure that its nonfederal programs do not have a negative financial impact on its HUD-funded programs.

Finding 2: The Authority Did Not Support Its Allocation of Salary Costs

The Authority did not support its allocation of administrative and maintenance salaries and benefits with activity reports or equivalent documentation as required. The Authority lacked support because its management was not aware that its salary had to be based on activity or other supporting reports. As a result, HUD has no assurance that the Authority used \$1.1 million in salary costs charged to its federal programs for HUD-funded activities.

The Authority Did Not Keep Activity Reports

The Authority had a salary cost allocation plan as required by federal regulations. However, it did not support its allocation of \$2.04 million in administrative and maintenance salaries and benefits with activity reports or equivalent documentation as required.⁷ In addition, the Authority's distribution of salaries to programs or entities did not coincide with the salary allocation plan. Therefore, some programs may have paid a disproportionate share of the salary costs.

The Executive Director's Estimate Was Used to Allocate Salary Costs

The Authority's executive director determined how salary costs were allocated among the Authority's programs and entities, including conventional public housing, Public Housing Capital Fund, Section 8, a nonprofit corporation and related entities. However, he was unaware the Authority's salary costs had to be based on activity or other supporting reports. The executive director did not ask the employees how much time they were spending on various programs and projects. Instead, he based the salary allocation plan on how much time he thought the staff spent on various programs or other entities.

⁷ Circular A-87, attachment B, paragraph 11h(4), see appendix C.

The Authority May Have Paid a Disproportionate Share of Salary Costs

Since the Authority lacked support, some programs may have paid a disproportionate share of the salary costs. From April 2002 to March 2005, the Authority paid \$2.04 million in salary costs, excluding benefits. The Authority allocated \$1.38 of the \$2.04 million to its federal programs. Some of the Authority's employees worked exclusively on HUD-funded programs, and their salaries totaling \$279,705 are supported. However, the Authority cannot support the remaining \$1,103,042 in salary costs for employees who were dividing their time between federal and nonfederal programs. The Authority needs to have a justifiable method of supporting allocated salary costs, including daily activity reports or equivalent documentation. Without an acceptable method of charging salary costs, the Authority will annually pay an estimated \$367,681 in unsupported salary costs.

Recommendations

We recommend that the program center coordinator, Houston Office of Public Housing (HUD), require the Authority to

- 2A. Provide documentation to justify the \$1,103,042 in unsupported salary costs allocated to HUD's programs from April 1, 2002, to March 31, 2005, and for later periods and reimburse HUD programs for any misallocated salary costs.
- 2B. Develop a reasonable method for allocating its future costs, including daily activity reports or equivalent documentation for services performed by its staff.
- 2C. Implement controls to prevent future unsupported salary costs from being charged to the federal programs, which we estimate to be about \$367,681 per year.

SCOPE AND METHODOLOGY

To accomplish our audit objective, we reviewed the following:

- Applicable laws, regulations, and other HUD program requirements;
- The Authority's contracts; and
- HUD's and the Authority's program files.

We reviewed various documents, including financial statements, general ledgers, bank statements, minutes from board meetings, check vouchers, invoices, loan documents, and reports from the independent public accountant. We also reviewed all related nonprofit entities' bylaws and incorporation documents. In addition, we obtained an understanding of the Authority's accounting system as it related to our review objective.

We reviewed the cost allocation plans and all of the salary records available for the period from April 2002 through March 2005 to determine whether salary costs charged to HUD programs were supported. We also interviewed the Houston Office of Public Housing's program officials, and the Authority's management and staff.

We assessed the reliability of the computer-processed data in the Authority's electronic check registers. We determined that the data were unreliable because we were unable to trace and confirm all of the transactions in the registers to the bank statements for March 2005. Therefore, we did not rely on the check registers. Instead, we reviewed bank statements, canceled checks, and general ledgers for the improper disbursements.

We performed the audit from April through August 2005. Our audit covered the period from April 1, 2002, through March 31, 2005, but we expanded our review of the nonprofit's general ledgers and bank statements back to October 1, 2001, because we identified a significant amount of transfers occurring to and from the bank accounts during that time.

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.
- Safeguarding of resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

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

Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The Authority did not have a system to ensure that federal funds were properly used and not put at risk (finding 1).
- The Authority did not have a system to ensure that costs charged among its various programs were properly supported (finding 2).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Funds to be put to better use <u>3/</u>
1A	\$592,360		
1B		\$34,846	
1C	\$200,000	\$99,985	
1G			\$5,589,080 ⁸
2A		\$1,103,042	
2C			\$367,681

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

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or classification of departmental policies and procedures.

3/ "Funds to be put to better use" are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

⁸ Represents \$5,956,761 in annual HUD funds the Authority will receive in the next year less the \$367,681 claimed in recommendation 2C.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments


Baytown Housing Authority
"Building Communities One Family At a Time"

December 9, 2005

Frank E. Baca
Regional Inspector General for Audit
U.S. Department of Housing & Urban Development
Office of Inspector General
819 Taylor Street
Room 13A09
Ft. Worth, TX 76102

Ref. Draft Report – Baytown Housing Authority Improperly advanced, transferred, and encumbered its Public Housing Funds

1. Due to serious personal health problems dealing with two heart attacks and two heart related operations and three periods of hospitalization during October and November

and
2. Due to the temporary reorganization of the BHA staff to meet the demands of assisting hurricane Katrina and Rita evacuees in the Houston/Baytown urban area
 - A. BHA became the City of Baytown agent to develop the FEMA Public Assistance Rental Program for over 400 evacuees
 - B. BHA is involved in working with the Houston HUD office to set up KDHAP – HUD FEMA program which will be assisting HUD assisted families – evacuees from hurricane Katrina
 - C. These families must be assisted immediately and the implication of the above programs must be given top priority by this agency

Because of the above urgent reasons both personally and BHA programmatic reasons is why I requested you to give additional time to work with our fee accountant – Lindsey and Co., with our current auditor Andy Blakeway and previous auditor – Robert & Jean Sickles to develop our complete response to your audit findings.

805 West Nazro, Baytown, Texas 77520 • (281) 427-6686 • Fax: (281) 422-4307 • www.baytownhousing.org

Comment 1

Comment 1

I explained to your staff that Andy Blakeway would be in the BHA office in December 2005. You refused to honor my request for additional time beyond December 9, 2005.

Comment 2

I gave your staff sufficient backup for every question that was asked during the several months of your audit procedures. I would like to request a copy of all supporting materials that I provided your staff during the audit. All the supporting schedules and reasons for decisions that we made were discussed over time with both sets of independent auditors and our response will include the consensus of their review during the various audit periods. I believe that when our final response is developed that all findings will be cleared.

Comment 3

I am in total disagreement with the conclusions drawn in the enclosed audit because they do not take into account all the funds Baytown Properties contributed annually to the BHA and its Low Rent Program from 1990 forward either by outright donations or payments of Low Rent expenses.

When Lindsey and Company took over the accounting in July 2001 and my employment in February 2002 we inherited an agency in total disarray as reflected by the June 30, 2001 CPA audit performed by Robert and Jean Sickles. All decisions made by myself and David Land of Lindsey to clear all the problems that we inherited have been discussed thoroughly with the fee auditors – Robert and Jean Sickles – 2000/2002 and/or Andy Blakeway 2003/2004 and 2005/current.

Comment 1

David Land from Lindsey and I will develop a very complete response to the audit with the assistance of the appropriate CPA auditor for the period involved. I stand by all decisions that I made during my tenure since February 2002. Our audit responses will be very specific and to the point and will show why we feel that we did not make an error in our decisions and why we feel that you have come to your wrong conclusions. I will be meeting with David Land from Lindsey as soon as feasible in January 2006 to develop our response.

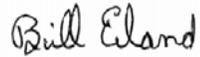
Due to all the reasons previously stated and due to the fact that I want the input of all the outside consultants who have helped me make decisions or have reviewed decisions made during the past years this response letter is the best response the I can write at this time.

Comment 1

Due to ever increasing demands on myself as the BHA Executive Director, the Board has consented to allow me to hire a full time accountant and finance director. I believe this will allow me to handle my responsibility without causing more health problems and also allow me to handle my responsibilities more efficiently.

I want to thank your staff for the courtesy shown myself and the BHA staff during their time in our office. I would like to request additional time for David Land to assist me in my response to this draft of the audit. If you should decide not to grant additional time prior to your release of this report then we will respond to the final report to Dan Rodriguez of the Houston HUD Office.

Sincerely,



Bill Eiland
Executive Director

OIG Evaluation of Auditee Comments

- Comment 1** The Authority asked for additional time to respond. The Authority's response did not indicate when its response would be complete but stated that it would begin developing it in January 2006. Since we had already granted the Authority an extension to formulate its response and informed it that we would issue the report if we did not have its comments by December 9, 2005, we have declined the Authority's request for an extension. As the Authority accurately states, it can respond to the final report to the director of the HUD Houston Public Housing Office.
- Comment 2** The Authority indicated it has provided sufficient backup for every question asked during the audit. We reviewed all of the information provided by the Authority and reached our conclusions based on the information provided and the criteria for the various programs.
- Comment 3** The Authority indicated it was in total disagreement with the conclusions in the audit. However, the Authority was not able to provide evidence during the audit or in this response to refute the conclusions and findings.

Appendix C

CRITERIA

Consolidated Annual Contributions Contract between HUD and the Authority, Part A

Section 7 of the contract between the Authority and HUD states that the Authority shall not in any way encumber any project or portion thereof without prior HUD approval. Section 7 of the contract further prohibits the Authority from pledging assets of any project covered under the contract as collateral for a loan.

Section 9(C) of the contract states in part that the Authority shall maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program regulation and requirement. Funds may only be withdrawn from the general fund for (1) the payment of the costs of development and operation of the projects under contract with HUD; (2) the purchase of investment securities as approved by HUD; and (3) such other purposes as may be specifically approved by HUD.

Section 10(C) of the contract states that the Authority shall not withdraw from any of the funds or accounts authorized under this section amounts for the projects under the contract, or for the other projects or enterprises, in excess of the amount then on deposit in respect thereto.

24 CFR [Code of Federal Regulations] 982.153, "HUD – Chapter IX Public and Indian Housing," requires that "The PHA [public housing authority] must comply with the consolidated ACC [contract], the application, HUD regulations and other requirements, and the PHA administrative plan."

24 CFR [Code of Federal Regulations] 982.155, "Chapter IX Public and Indian Housing" requires the Authority to determine that all existing reserves are not needed to cover public housing authority administrative expense. Only then can reserves be classed as "excess" reserves eligible for other uses. Once excess reserves are established, the public housing authority board must determine the amount of excess reserves that management can disburse without specific board approval. Section 982.155 (b)(3) states that "The PHA [public housing authority] Board of Commissioners or other authorized officials must establish the maximum amount that may be charged against the administrative fee reserve without specific approval."

The Baytown Housing Authority, Administrative Plan for Section 8 Housing Programs, chapter 1.Q, "Operating Reserves of the Administrative Plan," states that the board shall set a minimum balance for operating reserve and set a maximum amount management can disburse without specific board approval annually.

Office of Management Budget Circular A-87, attachment B, paragraph 11 h (4), states, in part, when employees work on multiple activities or costs objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation.