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Audit Report Number	2006-FW-1003
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TO: Dan Rodriguez
Program Center Coordinator, Office of Public Housing, 6EPH


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

SUBJECT: The Palacios Housing Authority, Palacios, Texas, Did Not Fully Comply with HUD's Standards

HIGHLIGHTS

What We Audited and Why

We conducted a review of the Palacios Housing Authority's (Authority) low-rent and Section 8 programs to determine whether the Authority operates the programs in accordance with U.S. Department of Housing and Urban Development (HUD) requirements.

What We Found

The Authority did not comply with HUD regulations because it could not fully support fund transfers between its Section 8 and its low-rent housing programs, made minor errors in its tenant files, and needed to improve its inspection process. However, the Authority's lack of compliance did not materially affect the Authority's housing programs, and it can easily correct its lack of compliance.

What We Recommend

We recommend HUD require the Authority to implement a budget-based approach in its operations, including using an approved documented cost

allocation plan, which will result in the Authority supporting an estimated \$44,657 in future fund transfers. Further, HUD should require the Authority to implement a quality control program to review all new tenant rent calculations, obtain additional inspection training, and include an exterior conditions assessment when it conducts unit inspections.

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

The auditee agreed with the report and said it was taking appropriate measures. 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 Palacios is located in Matagorda County on the southern coast of Texas. It established the Palacios Housing Authority in 1979 under the laws of the State of Texas. The Authority's primary objective is to provide housing to low-income residents. The mayor appoints the five-member board of commissioners (board) that governs the Authority. The Authority has only three employees: an executive director hired by the board to manage the Authority's day-to-day operations, a Section 8 administrator, and a maintenance person.

The small Authority is responsible for 101 HUD housing units. It administers a Section 8 Housing Choice Voucher program, consisting of 57 vouchers. It also operates Seacrest Estates, a 44-unit, low-income public housing complex, and maintains its office and records in this complex located at 45 Seashell Boulevard, Palacios, Texas. Since the Authority only has a three-member staff, the executive director performs tenant certifications for the low rent tenants and the Section 8 administrator performs tenant certifications for the voucher tenants.

During fiscal year 2004, HUD awarded the Authority \$269,347 to operate four housing programs:

Program	Award Amount
Low-rent	\$ 55,555
Section 8	165,339
Capital Fund	46,453
HOME grant	2,000
Total funding	\$269,347

The Authority's troubled performance prompted HUD in July 2005 to hire a consultant to help the Authority improve its operations. HUD used the consultant's report to prepare guidance that addresses deficiencies at the Authority and steps that the Authority must take to correct those deficiencies. HUD intends to monitor the Authority's compliance with the guidance for one year.

We selected the Authority for review because it was the most troubled public housing authority under the Houston Public Housing Office's jurisdiction at the beginning of fiscal year 2005. HUD designated the Authority as a troubled agency due to low management assessment scores in both its Section 8 and public housing low-rent programs during 2004. HUD's public housing staff in Houston attributed the Authority's problems to a high turnover in the executive director position and the ineffectiveness of past directors. The objective of this review was to determine whether the Authority operates its Section 8 and low-rent housing programs in accordance with HUD requirements.

RESULTS OF AUDIT

Finding: The Authority Did Not Fully Comply with HUD's Standards

The Authority did not properly document expenses, miscalculated tenant assistance, and did not ensure the livability of assisted units. This occurred because the Authority did not properly match revenues and expenses, and did not have an effective quality control system or well-trained staff. Consequently, the Authority may not have used its assistance funds in the most efficient or effective manner. However, the effects were not material to the Authority's housing programs, and the Authority can easily correct its noncompliance.

The Authority Could Not Fully Support Fund Transfers

During the review period, the Authority transferred at least \$44,657 from the Section 8 account to the low-rent account without using a written cost allocation plan. HUD allows transfers of federal funds between the two programs but requires an authority to use a written cost allocation plan to determine the amount of funds to transfer. Since the Authority did not use a written cost allocation plan, it cannot show how the transfers match each program's revenues to that program's expenses in accordance with its agreement with HUD and with sound financial management principles.

The Authority should implement a budget-based approach, including a written cost allocation plan, in its operations. Section 11 of the low-rent annual contributions contract between the Authority and HUD requires that the Authority prepare and its board approve an operating budget. A documented cost allocation plan detailing the costs to be charged to each program is a necessary component of any budget or expense management system. However, the Authority's fee accountant and HUD's consultant confirmed that the Authority does not use a budget-based approach in its operations and does not have an operating budget, appropriate budget controls, or an expense management system. If the Authority implements the budget-based approach, including a written cost allocation plan in its operations, it should be able to support future allocation transfers estimated at \$44,657 per year and should be better able to match program revenues to program expenses.

The Authority Made Minor Errors in the Tenant Files

The Authority did not reconcile contradictory information and miscalculated income and utility allowances in the tenant files, resulting in incorrect tenant recertifications that led to erroneous tenant assistance payments. The Authority needs to improve its rent calculation process because overassisting tenants prevents the Authority from operating its programs efficiently, while underassisting tenants could cause the Authority to violate HUD regulations that limit a tenant's share of rent. Although there were errors, the impact of the errors was not material, ranging between \$2.20 and \$7.00 per month for each tenant. The errors occurred because the Authority does not have sufficient staff to include a completely independent quality control function. However, it can minimize file errors if it requires both the executive director and the Section 8 administrator to conduct a quality control review of all tenant recertifications before implementing them.

The Authority Needed to Improve Its Inspections

The Authority enforced good overall housing conditions and livability but needed to improve its inspection process, especially in the area of exterior hazards. Ten of the eleven low-rent units and nine of ten Section 8 Housing Choice Voucher units failed inspection; however, there were few failure items per unit. The Authority's housing units averaged 2.1 to 2.5 failure items per unit, with only one unit having more than four failed items. Although the Authority's inspectors properly conducted inspections on the inside of units, many of the failed items occurred because the inspectors did not pay enough attention to conditions on the outside of those units. For example, the following pictures show two Section 8 units in which the Authority's inspectors had passed the units on their previous inspection and did not note old bare electrical wires hanging in the utility room of one unit or the ponding water under another unit.



Although the failure rate for the Authority's low-rent and Section 8 units was high, the number of failure items per unit was low. Further, most of the fail items, like frozen window screen locks, which would not open in an emergency, could be easily repaired. The Authority needs to improve its inspection process by increasing its inspection training, implementing a quality control review process to review a percentage of the units that it inspects, and paying more attention to conditions on the outside of each unit's living area.

Recommendations

We recommend that HUD require the Authority to

- 1A. Implement a budget-based approach in its operations, including a documented approved cost allocation plan, so that it can properly support an estimated \$44,657 in future transfers.
- 1B. Implement a quality control program in which both the executive director and the Section 8 administrator verify all new rent calculations.
- 1C. Provide its staff with additional housing quality standards inspection training, implement a quality control review process to review a percentage of the units that it inspects, and include an assessment of the exterior conditions of each unit that it inspects.
- 1D. Notify HUD when it has corrected the inspection issues identified during the review.

SCOPE AND METHODOLOGY

We conducted the review at the Authority's offices in Palacios, Texas, and the local HUD office in Houston, Texas. Our review period was from October 1, 2003, through July 31, 2005. During the review, we performed the following steps:

- Reviewed background information and the criteria that control the Authority's Section 8 and low-rent programs.
- Reviewed information on existing conditions at the Authority. The data included management assessment scores for both programs and a report prepared by an outside contractor hired by HUD to review the Authority's management of its low-rent program.
- Selected and reviewed a random sample of tenant files from the Section 8 and low-rent programs to verify tenant eligibility and conducted inspections to determine unit habitability.
- Performed a cursory review of the Authority's accounting records to gain an understanding of the type of expenses incurred by the Authority and determine whether there were any expenses that appeared questionable.
- Conducted interviews with Authority and HUD staff.

We performed the review at the Authority during two weeks in August and September 2005. Due to the effects of Hurricane Rita on the South Texas coast in September, we shortened portions of our planned review. We conducted our review 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 review objectives:

- Policies and procedures that the Authority put into place to reasonably ensure that its accounting system accurately matched program revenues with program expenses;
- Policies and procedures that the Authority put into place to reasonably ensure that it calculated assistance payments accurately and properly supported the calculations; and
- Policies and procedures that the Authority put into place to reasonably ensure that assisted units met or exceeded the minimal standards for decent, safe, and sanitary housing.

Significant Weaknesses

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

- The Authority's policies did not ensure that its procedures were consistent with its written policies and HUD's requirements.

APPENDIXES

Appendix A

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

Recommendation number	Funds to be put to better use <u>1/</u>
1A	\$44,657

1/ “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 a 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.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments



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December 19, 2005

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Region VI, Office of Inspector General
819 Taylor St., Room 13A09
Fort Worth, TX 76102

Re: OIG Audit of the Palacios Housing Authority

Mr. Baca:

This letter is in response to the above mentioned audit draft report. Please include these comments in your final report.

An exit interview was held at the office of the Palacios Housing Authority on December 15, 2005. Attending the interview were OIG officials Jacob L. Williams and Angela M. Wilson, Theresa Carroll via conference call, Chairman of the Board of Directors Leonard Lamar, and myself. As discussed during the interview, we are thankful for the information provided to us in order to improve our performance as a Public Housing entity.

We have already started to correct specific deficiencies and implemented recently acquired training and will continue to implement training as it is completed. UPCS training has been completed and inspections have already begun utilizing the UPCS standards. Quality control is being done on a cross reference basis using the HUD Black and White form. The Section 8 Administrator is doing the Low Rent files and I am doing the Section 8 files. The financial aspects of our organization are a major issue and are being addressed with our fee accountant and will be supported with additional training in this area as it becomes available. The Section 8 HQS Quality

Comment 1

Comment 2

Control inspections are being done in accordance with HUD regulations and should show great improvement with the review of our FYE '05 SEMAP.

If further information is required, or questions regarding the information provided in this letter are needed, please contact me at the number listed above.

Thank you,

A handwritten signature in black ink, appearing to read "Sherri Ellis". The signature is fluid and cursive, with the first name being more prominent.

Sherri Ellis
Executive Director

Cc: Dan Rodriguez
Lorraine Walls

OIG Evaluation of Auditee Comments

- Comment 1 The Authority agreed with the report and said that it was taking steps to correct the problems that we identified.
- Comment 2 Although the Authority is obtaining UPCS inspection training, the UPCS training is not the same as HQS training. The Authority should obtain both UPCS and HQS inspection training.