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TO: Lorraine Walls  
Acting Director, Office of Public Housing  
Houston Office, 6EPH

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

SUBJECT: Housing Authority of the City of Galveston, Texas  
Low Rent Program Procurement, Cash Management, Drug Elimination Grant,  
Cost Allocation, and Administrative Practices

At the request of former U.S. Representative Steve Stockman, we conducted a review of the Housing Authority of the City of Galveston, Texas (Authority). Our review covered the areas of: (1) supporting documentation for use of Low Rent Program funds; (2) procurement; (3) cash management; (4) use of Section 8 operating reserves to subsidize a non-HUD project; (5) Drug Elimination Grant activities; (6) administrative practices related to cost allocation, payroll, and travel; and (7) classification of employees under the Fair Labor Standards Act. We have provided a copy of this report to Sharon Strain, Executive Director.

Within 60 days, please give us, for each recommendation in the report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please furnish us copies of any correspondence or directives issued because of the audit.

If you have any questions, please contact Darrel Vaught, Assistant District Inspector General for Audit, at (817) 978-9309.

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# Executive Summary

Former U.S. Representative Steve Stockman requested we review the Housing Authority of the City of Galveston, Texas (Authority). Mr. Stockman expressed concerns regarding a local newspaper's stories on the Authority's use of Section 8 reserves to subsidize operations of Port Holiday Apartments, a non-HUD project the Authority acquired from the Resolution Trust Corporation. He also expressed concerns regarding Ventana Consulting Group's (Ventana) management review alleging fraudulent acts by the former Executive Director.

Ventana's 1996 report alluded to the possibility of irregularities, misuse of funds, and mismanagement of operations. Much of the report related to issues, such as the Authority's purchase and operation of Port Holiday Apartments and the Authority's use of Section 8 operating reserve funds to subsidize its operations. The report noted irregularities in travel cost reimbursement, procurement of auditing services, and potential for "ghost" employees on the Authority's payroll. Subsequently, the Authority's Board terminated the Executive Director in July 1996. Further, the Authority's Board was critical of its Finance Director's performance and ordered his termination in January 1997.

Our review concentrated on the Ventana's concerns regarding the Authority's proper use of HUD Low Rent funds. Specifically, we reviewed the Authority to determine whether it met HUD requirements for: (1) use of HUD Low Rent and Section 8 operating reserves by the former Executive Director; (2) procurement of contracts for construction, goods, and services; (3) cash management; (4) use of Drug Elimination Grant funds; and (5) administrative practices in reimbursing employee and commissioner travel, accounting for personnel costs including tracking employee time and classification under the Fair Labor Standards Act, allocation of costs to the various programs, and controlling personal use of Authority telephones and vehicles.

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Authority's use of Section 8 operating reserves for Port Holiday was proper, but its similar use of Low Rent funds violated HUD requirements

Although Ventana's report was critical of the Authority's use of over \$200,000 of Section 8 operating reserves to subsidize Port Holiday operations, HUD does not prohibit a housing authority from loaning its Section 8 operating reserves for housing related activities. However, the Authority improperly used about \$78,600 of its Low Rent funds to subsidize operations of Port Holiday Apartments and its affiliated nonprofit corporation. We are recommending HUD require the Authority to cease the improper use of Low Rent funds, repay the Low Rent Program, and impose appropriate administrative sanctions for continued violation of HUD restrictions on the use of funds.

Management improvement  
needed in several areas

Our review did not identify any fraudulent activity by the former Executive Director.<sup>1</sup> However, there are problems with the Authority's overall management that require corrective action. Specifically, the Authority:

- Lacks a management control system for ensuring their procurement process meets state, local, and HUD requirements. The Authority has not always procured goods and services with free and open competition and we are questioning \$23,050 for one unsupported contract cost increase and one sole-source financial assistance contract.
- Arbitrarily allocated joint costs among programs. Further, it improperly used \$37,000 of Comprehensive Grant funds to purchase computer hardware and software for the Section 8 Program; could not support its allocation of \$23,450 in employee salary to the Drug Elimination Grant Program; and did not recover from tenants \$52,700 of costs associated with providing cable television service.
- Kept \$2 million on deposit in a low-interest account, losing the opportunity to collect over \$100,000 from higher yield investments. The Authority also did not exercise appropriate controls over the drawdown of grant funds.
- Did not always ensure travel costs were reasonable and appropriate and did not prevent employees from making personal long distance telephone calls.
- May have misclassified some of its employees as exempt under the Fair Labor Standards Act.

HUD management  
consultant reports  
additional financial  
accounting problems

A HUD management consultant's draft report notes that the Authority's failure to hire a new Finance Director and replace vacant accounting positions has led to further degradation of the Authority's financial records.<sup>2</sup> As of the completion of OIG field work, the Authority's independent auditors had not

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1 We cannot state definitively that no fraud existed, just that none came to our attention during our review.

2 Quadel Consulting Corporation's Draft Report on Management Assessment of the Galveston (TX) Housing Authority.

issued their financial audit report on the Authority's fiscal year ending June 30, 1996.<sup>3</sup>

Authority management  
agrees to take corrective  
action

The findings and recommendations were discussed with the Executive Director and Chairperson at an exit conference on August 15, 1997. They expressed general agreement with the findings and recommendations. The Executive Director's written response, dated August 26, 1997, and included as Appendix A, states that the Authority will take the recommended corrective action.

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3 Office of Management and Budget Circular No. A-128 provides for annual audit reports to be submitted to the federal funding agency(ies) within 13 months of the fiscal year end. Therefore, the Authority's audit report became delinquent on July 31, 1997.

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# Table of Contents

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Management Memorandum	i
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Executive Summary	iii
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Introduction	1
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## Findings

1	Management System Needed for Procuring Goods and Services	7
2	Controls Needed to Ensure Propriety and Reasonableness of Costs Charged to HUD Programs	17
3	Stronger Cash Management Controls Needed	31
4	Improper Use of Low Rent Funds	37
5	Employee Classification May Not Comply with the Fair Labor Standards Act	41

---

Internal Controls	45
-------------------	----

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## Appendices

A	Auditee Comments	47
B	Schedule of Ineligible and Unsupported Costs	49
C	Distribution	51

## Abbreviations

CFR	Code of Federal Regulations
DOL	Department of Labor
FLSA	Fair Labor Standards Act
GRACE	Galveston Redevelopment and Community Enterprise
HUD	U. S. Department of Housing and Urban Development
OIG	Office of Inspector General
OMB	Office of Management and Budget



# Introduction

The City of Galveston created the Housing Authority in 1940. The Authority's governing body is its Board of Commissioners, comprised of five members. The Mayor of the City of Galveston appoints Board members to serve 2-year terms not to exceed a total of 6 years. The Board elects its officer positions. On August 28, 1995, Commissioner Christine Keller was elected Chairperson, replacing Mr. Edward Clack who retired. Since August 1996, Marc Cuenod, has been the Chairperson for the Authority.

The Board is responsible for setting policy and appoints an Executive Director to administer the day-to-day operations of Authority programs. The Board appointed Walter Norris in 1988. The Board dismissed Walter Norris July 1996. The Deputy Executive Director assumed the Executive Director's duties until May 1997, when the Board hired Sharon Strain as Executive Director.

The Authority administers the following HUD-assisted housing programs:

Program	Units
Low Rent Program (6 properties)	1,247
Section 23 Leased Housing (1 property)	160
Section 8 Existing Certificates Program	657
Section 8 Voucher Program	183
Section 8 Moderate Rehabilitation Program	28

During the past 3 fiscal years, the Authority received the following Low Rent operating subsidy, modernization, and Section 8 funding from HUD:

Program	Fiscal Year		
	1995	1996	1997
Low-Income Public Housing	\$1,916,467	\$2,415,935	\$2,220,017
Section 23 Leased Housing	88,960	58,036	73,720
Section 8 Existing	2,578,909	2,594,363	2,920,199
Section 8 Voucher	628,832	766,045	766,030
Section 8 Moderate Rehabilitation	77,991	93,707	87,073
Comprehensive Improvement Grant	2,368,028	1,971,956	1,927,956 <sup>4</sup>
Totals	\$7,659,187	\$7,900,042	\$7,994,995

4 Not yet approved by HUD as of 7/31/97.

The Authority has its central office and maintains its records at 4700 Broadway, Galveston, Texas, 77551.

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### Scope and Methodology

The objectives of our review were to determine whether the Authority met HUD requirements for proper: (1) use of HUD Low Rent and grant funds; (2) procurement of contracts for construction, goods, and services; (3) cash management; (4) use of Section 8 operating reserves; (5) eligibility of Drug Elimination Grant funds; and (6) administrative practices in reimbursing employee and commissioner travel, accounting for personnel costs including tracking employee time and classification under the Fair Labor Standards Act, allocation of costs to the various programs, and controlling personal use of Authority telephones and vehicles.

To accomplish these objectives, we obtained background information by:

- Reviewing the 1996 management report by Ventana Consulting Group.
- Reviewing relevant HUD regulations, guidelines, the Annual Contributions Contract, and OMB Circular No. A-87, Cost principles for State and local governments and Federally recognized indian tribes.
- Reviewing prior independent public accountant audit reports.
- Examining records maintained by the HUD Houston Area Office Public Housing Division and interviewed staff.
- Scanning the Authority's accounting records, financial reports, and policies, and interviewing Authority staff.
- Reviewing the minutes of the Board of Commissioners' meetings.

To determine if the Authority was following HUD requirements for procuring goods and professional services including following the Authority's adopted procurement policy, we:

- Reviewed Board minutes from July 1994 to August 1996 and contracts from the Accounts Payable Vendor Reports for the same period, since the Authority did not have a system for tracking contract awards.
- Judgmentally selected 19 contracts ranging between \$10,000 to \$850,000 and reviewed available records for adequate documentation of the history of the award; the competitiveness of the procurement; the contractual terms and provisions; change orders; and supporting eligibility of costs.
- Scanned the Accounts Payable Vendor Reports for fiscal years 1995 and 1996. Reviewed vendors that received cumulative payments of more than \$10,000 to identify evidence of bid splitting.
- Expanded our review to include Board awarded professional service contracts in fiscal year 1997 because of apparent Board violations in following HUD requirements.
- Interviewed appropriate HUD Field Office and Authority staff.

To determine if the Authority was following HUD requirements for cash management, we:

- Reviewed the Authority's fiscal years 1995, 1996, and 1997 bank balances for its Low Rent General Fund to identify cash available for investment and the amount of investment income the Authority received.
- Reviewed the Authority's draw down of grant funds from HUD's Line of Credit Control System for timeliness in relation to Authority expenditures and reviewed Authority interfund account balances to identify use of one program's cash to fund another program's expenditures.
- Reviewed the Authority's available records for investments, general depository agreement, and procurement records for obtaining proposals for banking services.

- Reviewed HUD public housing staff's report on their review of four resident initiatives grants.<sup>5</sup>
- Interviewed appropriate HUD Field Office and Authority staff.

To determine if the Authority properly used Section 8 operating reserves, we reviewed Authority reports to HUD and Authority financial reports, financial transactions, and supporting documents.

To determine if the Authority properly used HUD funds, we:

- Scanned the Authority's Financial Reports for the period July 1994 through July 1996, including the Low Rent general ledger, accounts payable reports, and cash disbursement journal for any unusual entries or atypical transactions.
- Using EZQuant<sup>6</sup>, selected a statistical random sample from 18,201 disbursements during the period, using 90 percent confidence level with a 5 percent error rate. Examined canceled checks and supporting documentation for the transactions.
- Reviewed the Authority's financial records and support for use of Authority funds regarding their non-profit corporation and affiliated apartment complex. Interviewed appropriate HUD Field Office staff, Authority staff, and related third parties.
- Reviewed payroll disbursements and selected employees to compare Authority paid salary to supporting documents for the period July 1994 through June 1996.

To determine if the Authority was following HUD requirements for administrative practices, including cost allocations, personnel, travel, and personal use of Authority vehicles and telephones, we:

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5 Resident initiative grants are HUD funded grants such as Drug Elimination, Youth Sports, Homeownership for People Everywhere (HOPE I), and Service Coordinators grant.

6 EZQuant is a statistical software package of the Defense Contract Audit Agency.

- Compared the Authority's travel policy with the City of Galveston's policy to determine if the Authority's practice was comparable, more restrictive, or more generous.
- Reviewed Authority practices for reimbursing travel expenses and compared them to the Authority's adopted travel policy.
- For the period July 1994 through June 1996, reviewed all travel vouchers for Board members, the Executive Director and Deputy Executive Director, and ten randomly selected staff vouchers. Reviewed supporting documents for proper submission of voucher, adequacy of receipts, and repayment of advances. Reviewed Authority credit card billings for related travel expenses.
- Reviewed Authority practices for assigning, controlling, and reporting requirements for the operation of Authority vehicles and scanned supporting documentation.
- Interviewed the Authority's Finance Director and staff to ascertain the Authority's methodology for allocating salaries of employees that work on more than one grant funded program and requested the Authority to provide documentation to support the allocation method.
- Scanned and randomly selected Authority invoices, for telephone, copying, and office equipment and supplies for the period July 1994 through March 1997, to determine cost eligibility, and proper allocation to supported programs. Interviewed appropriate Authority staff responsible for the review and allocation of administrative costs.
- Scanned Authority's invoices to ascertain the Authority's methodology for allocating salaries of employees that work on more than one grant funded program is supported.
- Reviewed job descriptions, classification, and compensation for all administrative employees and compared those duties to Department of Labor criteria for classifying employees as exempt under the Fair Labor Standards Act.

We conducted the audit in accordance with generally accepted government auditing standards. The audit generally covered, for the Authority's use of funds, the period from July 1994 through July 1996. The audit covered procurement, cash management, Drug Elimination Grant activities, Section 8 operating reserves, cost allocation, and compliance with Fair Labor Standards Act for the period from July 1994 through March 1997. We conducted the audit during the period October 1996 through June 1997.

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# Management System Needed for Procuring Goods and Services

**The Authority does not have a management system in place that ensures their procurement process meets state, local, and HUD requirements. Specifically, the Authority does not have ready access to information regarding who it has contracted with, for how long or for how much, and whether contracts are expiring or have expired. Further, the Authority did not properly identify or use evaluation factors with its competitive procurement or adequately document the contracting process. Further, the Authority generally did not use cost analyses to determine the reasonableness of costs for procurement of contracts or contract change orders. This occurred because the Authority procedures allowed untrained staff in its various departments to procure and administer contracts. Also, the Authority did not maintain a central location to file documents relating to the history of the procurement actions it undertook; thereby, allowing key documents to be lost or misplaced. Consequently, the Authority cannot assure HUD that it used full and open competition to obtain the best available price in its procurement transactions.**

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## HUD Requirements

HUD Regulations on Administrative Requirements for Grants and Cooperative Agreements with State, Local and Federally Recognized Indian Tribal Governments contain Federal procurement standards.<sup>7</sup> These regulations require the grantees:

- Have and use their own procurement standards that reflect applicable state and local laws and regulations, provided that the standards also conform to applicable federal laws and standards (85.36(b)(1));
- Conduct all procurement in a manner to provide full and open competition (85.36(c)(1));
- Maintain a contract administration system, which ensures that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders (85.36(b)(2));

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<sup>7</sup> HUD regulations at 24 CFR Part 85 Subsection 36. Regulations governing HUD funded programs, such as Low Rent Comprehensive Grant Program, Drug Elimination Program, etc. will note the applicability of these standards.

- Maintain sufficient records to detail the significant history of a procurement to show the rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price (85.36(b)(9));
- Perform a cost or price analysis in connection with every procurement action including contract modification (85.36(f)(1)); and
- Incorporate several specific provisions, such as: (a) administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms and (b) termination for cause and for convenience (85.36(i)).<sup>8</sup>

In addition, these regulations outline the methods of procurement to be followed. Procurement may be made by small purchases, sealed bids, competitive proposals, and noncompetitive proposals. The regulations also set forth the specific conditions that must be met for each type of procurement (85.36(d)).<sup>9</sup> The regulations also provide for the awarding agency to place a grantee on pre-award review when the grantee's procurement system fails to comply with the procurement standards, the grantee is to make the award without competition, or the grantee receives only one bid or offer in response to a solicitation (85.36(g)(2)).

#### Authority Requirements

Section (b)(1) of 24 CFR 85.36 requires the Authority to have and use their own procurement procedures which reflect applicable State and local laws and regulations. The Authority's Board of Commissioners' procurement policy contains the same or similar requirements to 24 CFR 85.36. The Authority's policy identifies procurement of less than \$10,000 to be under small purchase procedures.<sup>10</sup>

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8 Certain required provisions are dependent upon type and dollar amount of the contract, such as compliance with the Davis-Bacon Act for construction contracts in excess of \$2,000.

9 Procurement by noncompetitive proposals may be used only when the award of a contract is infeasible under the other methods, and certain specific criteria are met (24 CFR 85.36(d)(4)).

10 The Board adopted the procurement policy on January 24, 1992. Under 24 CFR 85.36, small purchase procedures involve obtaining quotes rather than formal solicitation of proposals or advertisement for bids.



Each Department handles its own procurement transactions and retains the records

The staff within each Department generally handle procurement for their respective Departments. The Authority's Purchasing Department may handle clerical aspects of procurement and provide assistance procuring professional services and other contracts; but, its involvement is minimal and it does not have authority to ensure procurements meet HUD and Authority requirements.

The decentralized procurement function has meant that untrained staff carry out the majority of significant purchases that require technical expertise.<sup>11</sup> Also, the individuals responsible for procurement maintained contract files in their location instead of in a central location. Further, the Authority didn't have an established system that defined what, where, or how documents would be maintained, allowing each individual to come up with their own unique and, in a lot of instances, very sketchy procurement history. As a result, Authority staff did not prepare or maintain all required documentation and could not always find documents.

Authority does not have a system to track contract activity

The Authority did not have a contract register, log, or similar system to record how many contracts had been awarded, the full amount of the contracts, the amount of any progress payments, and the balances due under the contracts.<sup>12</sup>

Since the Authority did not have a system in place to track contract activity, OIG attempted to identify the Authority's contract awards for the period July 1, 1994, through August 31, 1996, by reviewing: (a) automated Accounts Payable Vendor reports<sup>13</sup> for the period; (b) Board of Commissioners' minutes for discussion and/or approval of contracts in excess of \$10,000; and (c) Authority correspondence and reports. In addition, OIG queried

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- 11 HUD guidelines, HUD Handbook 7460.8 REV 1, Paragraph 3-6, Staffing and Training, state that successful procurement by Authorities will depend on staffing the procurement functions with persons qualified by training and experience. Further, a housing agency should have a formal training program for employees with procurement responsibilities. In November 1996, the Authority hosted HUD procurement training. Although a large number of staff attended, they did not necessarily attend all sessions and certain key employees involved in procurement transactions did not attend.
- 12 HUD Handbook 7510.1, prior to revision in May 1996, required housing authorities to maintain contract registers or logs for this purpose.
- 13 The vendor reports identify who the Authority paid, the number of payments, and total amount the Authority paid the vendor. The reports do not identify whether: (a) the vendor was a contractor or not; (b) the payment was for one or multiple contracts; (c) there were change orders; and (d) additional payments are required to complete the contract.

## Finding 1

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Authority staff for their knowledge and record of procurement activity during the selected period. However, this methodology could not readily identify the full extent of contracting during the period, but did allow the selection of contracts for review of the Authority's procurement practices.

From the available information, we identified 19 contracts requiring formal procurement procedures under the Authority's policy, as follows:

Contract Type	Number	Range	Contract Amount
Construction	3	Over \$300,000	\$ 1,707,996
	1	\$100,000 to \$299,999	193,249
Professional Services	1	Over \$100,000	150,000
	5	\$10,000 to \$99,999	102,550
Goods and Services	4	Over \$100,000	696,810
	5	\$10,000 to \$99,999	191,679
Totals	19		\$ 3,042,284

Authority does not adhere to HUD and Authority requirements for procurement of goods and services

The Authority did not fully follow HUD and Authority requirements in all 19 contracts. The following table summarizes the deficiencies noted:

Violation of HUD Requirements				
Missing or Incomplete Information	Construction	Professional	Goods & Services	Totals
Complete History		5	6	11
Contains Required Clauses	4	1	2	7
Written Contract Exists		3		3
Has Cost/Price Analysis		6	5	11
Done With Full/Open Competition		4	1	5
Proper Bid Opening	2	N/A	3 <sup>14</sup>	5
Totals	6	19	17	42

As shown, the most serious violations, involving no written contract and lack of free and open competition occurred in the Authority's procurement of professional contracts. The other deficiencies involve either poor recordkeeping or a lack of expertise on the part of the staff conducting the procurement.

To illustrate the violations and problems:

- In all six of the Authority's procurement of professional services, the Authority did not properly convey and evaluate the proposals as required by HUD regulations. The Authority used competitive proposals without informing potential bidders of the evaluation factors and/or the Authority did not establish methods for evaluating and selecting contractors from the proposals received. All seven competitive procurements did not include the evaluation factors in the request for proposals and only one documented the basis for selection. As a result, the Authority has no evidence it gave respondents a fair opportunity to present their qualifications, making the Authority's selection process appear arbitrary.
- In five of the eight formal bidding cases, the Authority could not locate all the bids submitted. For example, the Authority entered into a \$40,000 contract for technical assistance services for grant writing and monitoring. However, the Authority could not locate any proposals including that of the winning respondent. Thus, it cannot

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14 Four of the nine awards involved formal bids.

show proper procurements had taken place. In two of the five, the Authority did not have documents to support the bid openings.

- The Authority did not document the basis for the selection in 9 of the 19 contract awards. For example, the Authority entered into a \$150,000 architect/engineering contract without documenting the Authority's basis for selecting the firm. Further, the Authority: (a) did not have evidence it prepared a cost estimate; (b) did not include evaluation and selection criteria in the request for proposal; and (c) could not locate all of the competing proposals.
- Although the Authority used competitive means in selecting its legal services, the Authority did not have written and signed contracts with their attorneys. The Authority advertised separately for general counsel and tax advisor services. However, the Authority received one proposal for both services. The Authority separated the proposal into the two original areas. The Authority did not document how it evaluated the combined proposal and did not perform the required cost or price analysis.
- The Authority solicited proposals for a 2-year financial audit contract for fiscal years ending June 30, 1995, and 1996. The Authority could not locate the proposals it received, including that of the selected firm for \$13,900. Although the Authority prepared an analysis of all the proposals it received, the Authority did not identify the rating factors or the factors respective weight. The analysis showed there were two lower cost proposals, one for \$6,000 and another for \$7,200. However, the Authority did not document the basis for awarding the contract to the selected firm. In addition, the solicitation specified the Authority would award a 2-year contract. However, the Authority executed a contract for 3 years<sup>15</sup>.
- The Authority executed a computer hardware and software contract in January 1996 for a price of \$269,912. The Authority did not have documentation to evidence

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15 The firm completed the audit for the 1995 fiscal year. In June 1996, the Authority's Board of Commissioners voted to cancel the remaining 2 years of this contract.

that it properly advertised the procurement. The Authority did not have evidence it performed the required cost or price analysis and the Authority did not include evaluation and selection criteria for contract award in the request for proposal. The Authority also did not document the basis for the selection. Further, the vendor changed the contract price to \$317,000 primarily because the Authority increased the number of workstations and printers.

- The Authority did not timely detect that its fleet insurance contract was due to expire. As a result, the Authority executed a 1-year contract for \$32,495 with its insurer because it did not have time to solicit new proposals. The Authority executed the new contract with the understanding that the policy could be canceled if the Authority received a lower bid when the procurement for insurance took place. The Authority then advertised for fleet insurance to cover a 3-year period. The Authority received only one proposal from its existing insurer and the proposal was for only 1 year. Instead of readvertising for a 1-year period, the Authority retained its fleet insurance coverage with its insurer.

Board procurements also violate HUD requirements

The HUD Houston Area Office, in 1996, had advised the Authority that they could not pay a management consultant contract for \$39,378 with HUD program funds because the Authority did not follow HUD requirements for procurement of the services. Therefore, the OIG review also included professional services contracting activities conducted by the Board in 1997.

Although HUD had made the Board aware that HUD had specific standards applicable to contracting activities and failure to follow those requirements precluded use of HUD Low Rent and other grant funds, the Board of Commissioners still did not ensure they followed proper procurement procedures. The Board's award or amendment to the following contracts included violations of HUD requirements:

- After terminating the Authority's auditor, the Board undertook the procurement of future auditing services. Initially, the Board used qualification factors provided by Authority staff, which were minimal (see foregoing deficiencies identified with procurement of the former

auditors contract by Authority staff). The Board initially agreed to award the contract to a higher priced firm they perceived as being the best qualified. However, other firms, which met the minimal standards included in the Authority's request for proposal, had lower prices. The Board then issued a new request for proposal with more rating factors to obtain an auditing firm with the desired qualifications.<sup>16</sup> However, the following violations of HUD requirements still occurred:

- The Board received two proposals, evaluated the proposals, rejected the lowest price proposal as not qualified, and awarded the contract to the firm with the highest price. Although Board members sometimes disregarded the evaluation factors, OIG concluded the respondent with the lowest price proposal did not meet the established minimum qualifications for the award.
  - The Board did not do a cost/price analysis prior to award of the \$26,750 contract, which was approximately double their prior year audit costs.
  - The written agreement, drafted by the auditing firm, did not meet HUD requirements which require specific clauses; such as basis for termination and right to review records.
  - Subsequent to the contract award, without performing the required cost/price analysis, the Board approved a \$12,000 increase in the contract price.
- Subsequent to award of the audit contract, the Board awarded a \$11,050 contract to the same auditing firm for financial management assistance. Notwithstanding the prior HUD notice that the Authority could not spend Low Rent funds unless the Authority followed HUD requirements in procuring the services, the Board awarded this contract on a sole-source basis without competition.

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16 During the course of the audit, we verbally advised the Board that they would violate HUD procurement requirements if they continued with the award. Further, under OMB and HUD requirements for procurement of auditing services, any costs associated with the contract would be ineligible for federal funding.

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**Recommendations**

We recommend the Houston Office:

- 1A. Notify the Executive Director and each Commissioner of their responsibility to ensure that the Authority does not use HUD Low Rent and other grant funds, governed by 24 CFR 85.36, to pay for contracts unless the Authority follows all applicable HUD procurement requirements;
- 1B. Require the Authority to establish adequate management controls to identify, track, and monitor contract awards and payment activity;
- 1C. Place the Authority on contract post award review for a representative sample of contract awards in excess of \$10,000;
- 1D. Place the Authority on a preaward review if the post award review shows the Authority is still not in compliance with HUD requirements and continue such preaward review until such time the Authority demonstrates it has implemented adequate procedures and controls over procurement;
- 1E. Require the Authority to justify the reasonableness of costs for the increase in the independent audit contract and the sole-source financial management contract or repay the Low Rent Program \$23,050; and
- 1F. Impose administrative sanctions against Authority Commissioners or staff if they continue to disregard or willfully violate the HUD's regulations governing the procurement.

# Controls Needed to Ensure Propriety and Reasonableness of Costs Charged to HUD Programs

**The Authority has not implemented a system for incurring and allocating allowable costs to HUD funded programs. Instead, the Authority uses preestablished percentages to allocate joint costs to its various programs, but does not have documentation to support the basis for the allocations. As a result, the Authority: (a) could not support the propriety of \$23,450 it paid an employee from Drug Elimination Grant funds; (b) used over \$37,000 of Comprehensive Grant Funds to purchase computer equipment for the Section 8 Program; and (c) incurred \$55,750 in unreimbursed cost associated with providing cable television service to Low Rent residents. In addition, the Authority did not: (a) exercise control to ensure travel costs were reasonable, actually incurred, and Commissioners received only reimbursement for actual travel cost as required by State law; (b) exercise adequate control over employee use of telephones to prohibit personal long distance calls; or (c) follow Internal Revenue Service guidelines for employee use of Authority vehicles.**

## HUD Requirements

HUD regulations state grantees:

- Must maintain records that adequately identify the source and application of funds provided for financially assisted activities;
- Must maintain effective control and accountability for all grant cash, real and personal property, and other assets; and
- Will follow applicable OMB cost principles, agency program regulations, and the terms of grant agreements in determining the reasonableness, allowability, and allocability of costs.

OMB Circular A-87, Cost Principles for State and Local Governments,<sup>17</sup> sets forth the principles and standards for

<sup>17</sup> Paragraph C.1.a and b, Attachment A. HUD Regulations 24 CFR 990.201 require public housing authorities to follow financial requirements of 24 CFR 85.20, which require use of OMB Cost Principles.



determining costs applicable to federally funded programs. These principles provide the general criteria necessary for costs to be allowable under federal awards. These principles state:

- Costs must be necessary and reasonable for proper and efficient performance and administration of federal awards, be allocable thereto under federal cost principles, and be authorized or not prohibited under State or local laws or regulations and be adequately documented (Attachment A, Part C.1.a., c., and j.)
- Costs, to be reasonable, involve whether: (a) the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the federal government and (b) significant deviations from the established practices of the governmental unit, which may unjustifiably increase the federal award's cost (Attachment A, Part C.2d. and e.);
- A cost is allocable to a particular cost objective to the extent of benefits received by such objective (Attachment A, Part C.2.a.);
- Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by personnel activity reports, signed by the employee, prepared at least monthly, and reflects after the fact the actual activity of each employee for distribution of salary costs of each employee (Attachment B.11.h.)
- Costs of alcoholic beverages are unallowable (Attachment B.4.); and
- Costs of entertainment, including amusement, diversion, and social activities and any cost directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable (Attachment B, Part D.4 -Attachment B.18.).

The Annual Contributions Contract for the Low-Rent Public Housing Program (Low-Rent Contract) governs the operation of the Low Rent Program. The Low-Rent Contract requires

the Authority to: (1) adopt travel polices comparable to pertinent local public practices and (2) maintain complete and accurate accounting records.<sup>18</sup>

#### State Law

Texas statutes state housing authority commissioners may not receive compensation, but may be reimbursed for travel expenses incurred in performing necessary business. Case law based on the statute notes that commissioners are required to submit receipts for each singular expense item.<sup>19</sup>

#### Authority's Personnel Policy

Section 8 of the Authority's personnel policy governing travel provide that:

- The Authority expects each person authorized to travel on Authority business to exercise good judgment and a regard for economy when incurring travel expenses. The Authority will only reimburse expenses the Authority judges to be in the best interest of the Authority.
- Only employees, members of the Board of Commissioners, and other authorized persons on Authority business may be reimbursed for travel on approved official trips.
- Allowances for meals and tips (15%) will be in the amount of \$57.50 per day (policy does not require traveler to provide receipts for meals).<sup>20</sup>
- Taxi and limousine expenses will be reimbursed at the actual cost (traveler must provide receipts for limousine fare).

Section 7 and 8 of the Authority's personnel policy relating to vehicle allowances and Authority vehicles provides that:

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- 18 Annual Contributions Contract, Part II, Section 307. The Section 8 Annual Contributions Contract, Part II, Paragraph 2.5.(A) does not have a specific requirement for adoption of travel policies; however, complete and accurate records are required to be maintained. The Authority has not entered into the New Consolidated Contributions Contract issued in 1995. The revised Annual Contribution Contract eliminates the requirement for "comparability" under Section 307. However, OMB A-87 would still apply, and costs would still have to be supported, necessary, and reasonable.
- 19 Section 392.035, Local Government Code, Vernon's Texas Codes Annotated, effective September 1, 1987. Housing Authority of City of Harlingen v. State ex rel. Velasquez (539 S.W.2d 911).
- 20 Sections C and E of the City of Galveston's travel regulations state expenses for meals will be reimbursed up to \$30 per day. Receipts are not required. Tips are allowed to a maximum of 15% of the \$30 meal allowance.

- The Authority will not pay an individual receiving a stated amount of car allowance for mileage incurred on trips made within 50 miles of the City of Galveston. As a guideline, the policy notes the Authority will not pay a traveler's mileage for a trip to Houston and back if the traveler has a car allowance; but, individuals may claim expenses incidental to the trip.
- No Authority vehicle or piece of equipment may be used for personal business or pleasure.

Internal Revenue Service Requirements

Internal Revenue Service Publication 535 requires employers to include in an employee's taxable income the value of fringe benefits. The publication defines a fringe benefit as a form of compensation provided to any person for the performance of services. The compensation may include any property provided by the employer such as an automobile, even if the employer requires the employee to take the vehicle home. The publication provides various methods to determine the value.

The Authority could not support its methodology for allocating salaries among its programs

The Authority cannot support how it allocates administrative salaries among its various programs. As a result, there is no assurance that salary costs charged to any program is accurate (i.e., overcharging one or more programs while undercharging others). According to responsible Authority personnel, the salary allocations are preset in the computer for each employee. The Acting Finance Director, who's duties now include salary allocation, does not know when the Authority last evaluated or changed the preset allocation percentages.

The Authority does not require all employees to prepare time records and, for the employees that do prepare time records, the time sheets are not in a format to show the time spent on different programs. Four Authority employees did use a time sheet that captured time by program. However, the Authority did not use these time sheets to allocate these four employees' salary cost. The following illustrates that the Authority's preset percentage allocation method is inaccurate when compared to actual time sheets for two of the four employees:

Percentage of Actual Time to Authority Allocated Time	
	Percentage

Program	Employee 1		Employee 2	
	Actual	Allocated	Actual	Allocated
Low Rent	28.75	60.00	28.75	35.00
Comprehensive Grant	38.75	35.00	33.50	60.00
Drug Elimination Grant	11.25		4.375	
Youth Build Grant	7.50		10.625	
Development Grant	2.50		3.75	
Section 8 Existing	1.25		2.50	
Section 23 Leased	1.25	5.00	4.375	5.00
Hope I Grant	1.25		5.0	
Sick Leave	6.00			

Federal cost principles have always required salary costs for employees devoting time to more than one cost objective be based on time distribution records. However, in 1995, OMB revised the principles to specifically require grantees allocate joint salary costs on the basis of time activity reports. Further, these cost principles require the employee to sign the time activity report and to prepare the report after expending the time on the activity.

Therefore, the Authority's method of using preset allocation percentages violates federal cost principles and does not result in the Authority equitably charging such costs to the various program. The Authority's system effectively overcharges costs to some programs while undercharging others.

Authority also lacks support for allocation of other administrative costs to its various programs

Besides administrative salaries, the Authority does not properly allocate other administrative costs to its programs. For example:

- The Authority uses preestablished percentages to allocate the cost of operating two office copiers used by the administrative departments at the Authority's main office. The Authority uses the following percentages: (a) 75 percent - Section 8 Existing; (b) 5 percent - 1994 Comprehensive grant; (c) 5 percent - Service Coordinator Grant; and (d) 15 percent - Low Rent Program. Yet the

Authority has the ability to track and allocate usage by department<sup>21</sup>.

- The Authority charged the cost of two printers and supplies used by the Finance and Management Information Systems Departments solely to the Low-Rent Program. However, these two departments provide services that benefit all of the Authority's programs and grants.
- The Authority arbitrarily allocates the costs of its main office telephone equipment to five programs as follows: (a) 73 percent - Low Rent; (b) 10 percent - both to Section 8 Existing and Section 23 Leased Housing Programs; (c) 6 percent - 1994 Comprehensive Grant; and (d) 1 percent - Development Grant. However, this equipment benefits all Authority programs<sup>22</sup>.
- The Authority does not allocate other administrative costs such as: maintenance, utilities, and security costs to the Section 8 Program. Since the Section 8 Program uses space in the main building, the Authority is not properly charging the program for the benefit of these joint services.<sup>23</sup>

The Authority charged unsupported salary expense to Drug Elimination Grants

The Authority cannot support \$23,450 the Authority paid in salary to a housing manager between July 1995 and February 1997. The Authority paid the employee for 10 hours over the normal 40-hour work week.<sup>24</sup> The Authority paid the additional salary from the 1994 and the 1995 Drug Elimination grants for services as a Recreational Coordinator. However:

- The Authority did not identify a Recreational Coordinator position to be funded with the Drug Elimination Grants.

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21 One of the Authority's copy machines is equipped with an Auditron System which automatically tracks the number of copies a particular user (department) makes.

22 Authority telephone equipment located in remote locations are properly allocated to the specific programs they apply to.

23 The Authority could allocate these indirect costs to the Section 8 Programs based on office square footage or other methods that would provide an equitable distribution of costs.

24 The employee's position required him to perform Housing Manager responsibilities at both a low rent property and Port Holiday Apartments (a non-HUD funded program). For the normal 80-hour pay period, the employee worked 44 and 36 hours, respectively, in the above Authority programs. Authority records show it properly repaid the Low Rent Program for the employee's time devoted to Port Holiday.

- The Authority could locate only three biweekly time sheets for the employee during the period. The available time sheets showed the employee did devote 50 hours per week to work. However, although the employee separated out the time spent at Port Holiday (non-HUD funded project), he did not separate out the remaining time to show the work was devoted to Drug Elimination funded activities. Further, the Authority did not have other records or activity reports to show the individual worked on drug elimination activities.
- According to the employee, he worked as a housing manager during normal business hours at both the Low Rent property and the non-HUD funded apartment complex. Further, he said he spent approximately 10 hours a week on drug elimination activities outside of normal business hours.

However, it appears that the Authority arbitrarily allocated 28 percent of the employees salary and benefits to the Drug Elimination grants. As a result, the Authority's allocation of his salary is not supported and does not conform to federal cost principle requirements for documenting salary charges.

The Authority improperly uses Comprehensive Grant funds for Section 8 Program computer costs

The Authority used Comprehensive Grant Program funds to upgrade their computer system for all Authority programs. The Authority purchased new computer hardware, software, and software support services. The Authority contracted in January 1996 with its vendor to furnish hardware, software, installation, training, and related services. The Authority has expended over \$300,000 on this ongoing contract.

HUD regulations for Modernization specifically limit the eligible costs of physical and management improvements, including administrative costs, only to amounts directly attributable to the public housing program.<sup>25</sup> The costs where other programs benefit such as Section 8 or local revitalization are not eligible.

The Authority has spent \$37,486 on computer hardware and software that benefits the Section 8 Program. The following

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<sup>25</sup> Current regulations at 24 CFR 968.112(n)(3), effective May 1, 1996, and prior regulations at 24 CFR 968.310(m)(3), effective February 14, 1992.

table shows the direct and indirect costs for hardware and software costs the Authority incurred for the Section 8 Program:<sup>26</sup>

Description	Amount
Direct Hardware Cost	\$ 23,428
Direct Software Costs	7,490
Indirect Hardware Costs	2,468
Indirect Software Costs	4,100
<b>Total Costs</b>	<b>\$ 37,486</b>

The Authority does not recover its costs from tenants for providing cable television service

During the period July 1993 through May 1997, the Authority paid \$52,747 more in cable fees than it collected from tenants. This occurred because the Authority failed to compare the cost of the cable service to the fees the Authority charges residents. Neither the Authority nor the cable company could locate a written contract for the service. The cable company bills the Authority a bulk rate based on the number of units per site<sup>27</sup>. The Authority charges residents \$12 per month. In May 1997, the cable company billed the Authority \$13,426 for 1,381 units. However, the Authority, in turn, collected only \$10,728 from its residents (a \$2,698 shortfall).

According to the Acting Finance Director, the Authority is subsidizing the cable service because it does not want to adversely impact its elderly residents, or terminate the cable bulk rate fee arrangement because it would substantially increase the residents' cost for individual cable television service.<sup>28</sup>

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26 Direct costs include the contract price for workstations (computer, monitor, etc.), laser printers, printer and ethernet cards, and Section 8 Program software. The indirect cost of the system hardware and software represents the contract price for the Network Server and System software. OIG allocated these indirect costs to the Section 8 Program using a ratio of 8 Section 8 Program workstations to the 61 total workstations using the Server and the System software.

27 The bulk rate is based on the number of units at each site, including vacant units.

28 The cable company represented that its individual subscriber fees to the residents would be about \$28 per month.

Authority does not exercise prudent control over travel costs

The Authority has not ensured that it compensates employees and Commissioners only for reasonable travel costs. For example, the Authority gives staff and Commissioners travel advances based on \$57.50 per diem for meals plus \$25 to \$150 for taxi and other miscellaneous items. (The Authority generally uses its credit card to pay airfare and pays hotels by check.) However, the Authority's travel policy does not specify when the traveler is to submit travel expense vouchers. Authority records, for travel during its 1995 and 1996 fiscal years, show that the Authority provided advances of \$3,406 for 14 trips made by staff and Commissioners. The Authority did not have travel vouchers with accompanying receipts to support the proper use of the advances. Also, although travelers submitted travel vouchers for 19 advances totaling \$5,255, the employee had not signed the voucher form certification that the claim was in accord with Authority policy or always provided receipts when required. As a result, the Authority does not have assurance that employees and Commissioners properly used the travel advances in accord with Authority policy.

The Authority's \$57.50 per diem for travel is excessive when compared to local public practice of paying \$34.50 for meals and federal agency practice of paying \$30 to \$42 for meals and incidental expenses.<sup>29</sup> In addition, the City requires employees to submit travel vouchers to be submitted to the City within 30 days of travel. The City traveler must repay to the City any portion of the unused travel advance. The City also requires the employee include detail receipts with the travel voucher. However, the Authority does not exercise these prudent controls over travel advances.

The Authority's payment of a per diem allowance to Commissioners violates State law which requires the Authority to reimburse Commissioners only for actual expenses they incur. The Authority also paid travel expenses for Commissioners and the former Executive Director that were either excessive or violated the Authority policy and federal cost principles, as follows:

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<sup>29</sup> The Authority's travel policy shows it would pay 50 percent of the per diem amount from non-HUD funds as a local match. However, OIG's review of 80 vouchers identified only 6 where the Authority used non-HUD funds to pay any portion of the per diem.



- On five different occasions, the Authority paid airfare for a spouse or family member to accompany a commissioner while on official travel. Three Commissioners reimbursed the Authority. In the other two cases, the Authority purchased four airline tickets for half the full fare under an airline promotion to "buy one, get one free." The Authority allowed two Commissioners to use these tickets for themselves and their accompanying spouses. For the same travel to a Las Vegas conference, the Authority purchased two additional full fare tickets instead of using the half fare tickets for two other Commissioners.
- For the two Commissioners with accompanying spouses to the Las Vegas conference, the Authority paid \$169 for the Commissioners and their spouses to have dinner and attend a Las Vegas show. Under federal cost principles, HUD funds cannot be used for alcohol and entertainment expenses.

The Authority also used HUD funds to pay excessive or improper expenses incurred by the former Executive Director, as follows:

- The Authority also used HUD funds to reimburse the former Executive Director, while attending a training conference, \$321 for entertainment expenses, which included liquor, food, and theater tickets.
- The Authority, on two occasions, reimbursed the former Executive Director for his hotel and/or rental car expenses in excess of the costs he incurred for official travel. For personal reasons, the former Executive Director had extended stays of 2 days in excess of the time needed for the conference he was attending. These additional costs totaled \$166 for the trip to Jacksonville, Florida, and \$228 for the trip to Alexandria, Virginia.
- Although the former executive director received a car allowance, there were four instances where the Authority reimbursed him mileage totaling \$100.80 for various trips that required traveling to Houston, Texas, in order to begin his airline travel. The Authority's travel policy specifically prohibited mileage in such cases.

- The Authority also reimbursed the former executive director for tips of \$20 each to skycaps and bellmen (without receipts) on several trips. The former executive director did not provide receipts or explanation for the unusually high tips totaling \$520. The Authority's policy specifically admonished travelers to use good judgment and economize on travel expenses.

Authority staff use telephones to make personal long distance calls

The Authority's telephone system does not always identify the specific telephone instrument used by staff in making long distance calls. Although not consistently used, the Authority had staff make telephone logs to identify their long distance calls. The telephone records show the former Executive Director and other staff made personal long distance calls using Authority telephones.

The Authority records did not readily identify whether these employees had reimbursed the Authority for all of their personal long distance calls. Consequently, because the Authority does not prohibit personal use of Authority telephones and has not established adequate controls to ensure employees reimburse the Authority, the Authority is not ensuring that it uses HUD funds to pay only for official HUD-related business expenses of the Authority.

The Authority is not properly reporting the personal use of an Authority vehicle to the IRS

The Authority allows only its Maintenance Director to take his Authority owned vehicle home. The Internal Revenue Service requires employers that furnish vehicles to employees to maintain specific records and report the value of the use of the vehicle as additional taxable income in the employee's Internal Revenue Service Form W-2. However, the Authority had not maintained the appropriate records or reported the use value to the Internal Revenue Service.

## Recommendations

We recommend the Houston Field Office require the Authority to:

- 2A. Establish and implement a cost allocation plan for joint costs that meets Federal cost principles, including time activity reports for personnel salaries chargeable to more than one program;

- 2B. Either support or pay back to the Drug Elimination Grants the \$23,450 paid for a Recreational Coordinator;
- 2C. Reimburse the Comprehensive Grant program the \$37,486 computer system cost and any additional costs associated with the Section 8 Program;
- 2D. To adjust its cable fee charges to residents to an amount sufficient to cover its costs and to periodically analyze its cable costs to ensure it continues to recover its costs;
- 2E. Establish and implement management controls to ensure travel costs are reasonable and conform to Authority policy and Federal cost principles;
- 2F. Cease paying per diem to Commissioners in violation of State law;
- 2G. Obtain reimbursement of \$490 from the Commissioners and Executive Director for their improper claim for alcohol and entertainment expense;
- 2H. Obtain reimbursement from the former Executive Director the \$393 the Authority paid for unofficial extended stays at travel sites;
  
- 2I. Implement controls to prevent staff from making personal long distance calls; and
- 2J. Follow Internal Revenue Service requirements to maintain appropriate records and report use value of Authority vehicles as employee taxable income.

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## Stronger Cash Management Controls Needed

**The Authority's weak cash management practices meant it: (1) lost the opportunity to earn \$100,000 in interest income; (2) used \$857,000 of its Low Rent operating funds to pay other grant program expenditures when grant funds were available; and (3) did not execute the HUD required Depository Agreement with its banking institution and may not have properly procured its banking services.**

### HUD Requirements

The Annual Contributions Contract, Part II, Article IV, Section 401, requires the Authority to invest excess cash in the General Fund in investment securities selected by the Authority and approved by HUD. HUD defines the General Fund as all monies and investments securities received by or held for the account of the housing authorities in connection with the development, operation, and improvement of projects under contract. HUD Notice 95-27, issued May 11, 1995, states:<sup>30</sup>

- HUD defines excess monies as funds in excess of prudently estimated needs for the next 90 days.
- In the interest of good cash management, non-interest bearing deposits should be reduced to the amount necessary to maintain a good banking relationship.
- HUD regulations, 24 CFR 85.20, require authorities to establish good cash management procedures. Cash management is the process of managing the cash flow of a housing authority to optimize its use of funds. This process involves the timing of receipts and disbursements to assure the availability of funds to meet expenditures and to maximize the yield from the investment of temporarily surplus funds. Effective cash management calls for organized planning.
- Under the Modernization and Development Programs, the term "cash management" also means minimizing the time elapsing between the housing authority's drawdown and

<sup>30</sup> On June 4, 1996, HUD reissued this Notice with minor changes as HUD Notice PIH 96-33 with an expiration date of June 30, 1997. On July 21, 1997, HUD issued Notice 97-41 extending the expiration date to July 31, 1998.

disbursement of funds. HUD has established the maximum time to be generally 3 working days.

- Banking services shall be arranged by periodically selecting a bank through competitive solicitation to assure the housing authority that it receives the banking services provided at the lowest cost.
- HUD requires housing authorities to execute a General Depository Agreement, Form HUD-51999, with its banking institution, which must be a financial institution with Federal Deposit Insurance Corporation or National Credit Union Share Insurance Fund insured deposits.

HUD also includes the above requirements and provides guidance to housing authorities in carrying them out in two publications: HUD Handbook 7510, Public and Indian Housing Low-Rent Technical Accounting Guide, January 1996, and Chapter 4, HUD Handbook 7475.1, Financial Management Handbook, March 1989.

Authority could have earned substantial investment income

During its fiscal years 1995 and 1996, the Authority had investment income of \$45,192; however, had the Authority properly managed its investments, it could have earned as much as \$143,000 for the same period.<sup>31</sup> The Authority invested its general funds in a money market checking account earning about 1.5 percent interest instead of other higher yield investments, such as certificates of deposit. The Authority's former finance director said the Board had not adopted an investment plan and he suggested there is no incentive for the agency to generate extra interest income because HUD would deduct the amount from future federal allocations. However, that is incorrect. HUD requires housing authorities to invest funds at the most optimum rate, consistent with HUD's restrictions on the type of investment security. HUD reduces the annual operating subsidy by the amount a housing authority should have earned. HUD does not reduce operating subsidies for any earnings in excess of average yield on 91-day Treasury Bills, thereby creating an incentive.

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31 HUD requires, as part of the Performance Funding System (calculation of operating subsidy) that housing authorities impute a target rate of interest based on average yield for 91-day Treasury Bills. HUD based its target investment income interest rates for fiscal years 1994 and 1995 on 5.29 percent and 5.17 percent, respectively. The Authority's bank, in May 1995, advised the Authority that it would pay 10 basis points above the yield for 91-day Treasury Bills for 7- to 365-day Certificates of Deposit of \$100,000 or more.

Authority does not effectively manage its drawdown of HUD grant funds

HUD allows housing authorities administering modernization, development, and other HUD grant funded activities to draw funds down as needed. HUD permits the drawdown of funds in advance of the disbursement, but generally limits the draw to a maximum of 3 working days prior to scheduled disbursement. However, because the Authority did not exercise adequate cash management controls over the drawdown and expenditure of these funds, the Authority has: (1) used general operating funds to pay for specific grant supported activities or (2) drawn down grant funds in excess of the amount needed to meet the Authority's immediate needs. In the first case, the use of general operating funds in lieu of available grant funds, reduces the funds the Authority has available to invest. In the latter case, the Authority is violating HUD requirements by drawing funds down significantly in advance of its need for those funds.<sup>32</sup>

The Authority's books, at January 31, 1997, showed various HUD grants owed the general fund \$649,539, representing operating funds disbursed for grant activities. At March 31, 1997, the Authority's books showed \$857,884 due from various grants to the general operating fund, an increase of \$200,000 in the 2-month period.

Because the Authority fails to timely reimburse the general fund for grant activities, the Authority's financial information reported to HUD for grant activities does not agree with HUD's fiscal data on drawdowns. This situation, in part, led to HUD's February 20, 1997 letter to the Authority declaring the Authority in default on two of its HUD grants and a preliminary determination of default on another.

To illustrate the problem:

- 1994 Drug Elimination Grant - This grant expired on March 31, 1996. Authority records show grant expenditures of \$61,310 in excess of the Authority's drawdown of grant funds. However, the Authority did not attempt to draw down these funds until September 30, 1996, some 6 months after the expiration of the grant. Further, because of the Authority does not have effective

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32 The U.S. Treasury obtains funds to meet obligations through borrowing, e.g., U.S. Treasury Bills. Thus, an entity's drawdown of funds in excess of needs results in a higher interest cost to the federal government.

system, the Authority did not discover, until March 1997, that the U.S. Treasury never transmitted the funds to its bank account.<sup>33</sup>

- 1995 Drug Elimination Grant - Authority records show that the Authority has used all but about \$1,800 of its grant funds. However, HUD records show the Authority has not drawn down over \$143,000 of available grant funds.
- Homeownership for People Everywhere (HOPE I) - Authority records, at March 31, 1997, show the Authority expended about \$361,000. However, HUD's records show the Authority has drawn down \$435,300, a \$74,300 difference. Authority records show it has at least \$67,500 of these excess HOPE I grant fund on hand in the Low Rent general fund. Therefore, the Authority has drawn down funds in excess of its needs, thus violating HUD's requirement that the Authority draw down only those funds to be disbursed within 3 working days.
- 1995 Service Coordinators Grant - HUD records show the Authority has not drawn down any funds for this grant, which started on December 1, 1995. However, the Authority's records show it has expended about \$8,200 for grant activities.

The Authority has not executed the HUD required Depository Agreement with its bank

The Authority has not executed the HUD Depository Agreement with its banking institution. Further, the Authority did not have records to show it used competitive negotiation in obtaining its banking services. The current Agreement does not include the following HUD required clauses:

- If the depository receives written notice from HUD that no withdrawals by the authority from the account are to be permitted, the depository shall honor that request;
- The rights and duties of the depository under this agreement shall not be transferred or assigned by the depository without prior authority and HUD approval;

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33 At the completion of OIG's field work, HUD had not made a final determination on whether the Authority will be allowed to draw down these expired grant funds.



- HUD is intended to be a third-party beneficiary of this agreement and may sue to enforce its provisions and to recover damages for failure to carry out its terms; and
- The provisions of this agreement may not be modified by either party without prior written HUD approval.

Therefore, the Authority has not met HUD requirements, which give HUD the authority to exercise control over the Authority's bank accounts. Thus, HUD could have difficulty in exercising its rights in the event HUD declares a breach of its contracts with the Authority.

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## Recommendations

We recommend the Houston Office require the Authority to:

- 3A. Develop and implement a cash management system that will ensure the Authority invests its funds to maximize interest income and timely draws down grant funds within 3 working days of when it needs the funds;
- 3B. Immediately execute HUD's General Depository Agreement with its banking institution; and
- 3C. Take action to competitively solicit banking services for its general fund.

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## Improper Use of Low Rent Funds

**As of March 31, 1997, the Authority has used \$78,671 of Low Rent Program funds to cover expenses incurred by an affiliated non-profit corporation and the Port Holiday apartment complex. Because these entities did not have funds readily available to meet their obligations, the Authority chose to improperly use Low Rent Program funds, which violated its Annual Contributions Contract with HUD.**

### HUD Requirements

Section 313, Part II of the Annual Contributions Contract prohibits housing authorities from using Low Rent Program revenues (rents and HUD subsidies) for purposes other than operating this Program. Section 406 further states that operating expenses paid from Program revenues must be for the necessary operations of the Low Rent Program to provide low income families with decent, safe, and sanitary living conditions<sup>34</sup>.

### Authority uses \$53,601 of Low Rent funds to subsidize GRACE Corporation

From July 1, 1994, through May 31, 1996, the Authority used \$44,275 of Low Rent Program funds to pay for expenses of the Galveston Redevelopment and Community Enterprise (GRACE) Corporation. The Authority's records show it used Low Rent Program funds for GRACE Corporation expenses, such as: property taxes, loan repayments, administrative salaries, and insurance.

In March 1996, the HUD Houston Office directed the Authority to recover, by June 30, 1996, funds owed the Low Rent Program by the GRACE Corporation. The Authority's former finance director, on July 16, 1996, wrote the GRACE Corporation's Board noting HUD's instructions to the Authority to recover the monies owed.

Subsequently, the Authority used another \$9,326 of Low Rent funds to support the GRACE Corporation. The Authority's Board of Commissioners is also the Board of Directors for GRACE Corporation. As of March 31, 1997, the Authority's

<sup>34</sup> In July 1995, HUD revised the standard language in the Annual Contributions Contract. The revised language still prohibits the use of Low Rent funds for other purposes. As of March 31, 1997, the Authority had not executed the revised contract with HUD.

general ledger shows GRACE Corporation owes the Low Rent Program \$53,601.

The Board's Chairperson stated that although GRACE Corporation had the assets to pay the Authority, it did not do so because the Authority's Finance Director had not adequately explained the amount the Authority was claiming for administrative support costs.

Authority uses \$58,978 of Low Rent funds to subsidize Port Holiday Apartments

Up and till March 31, 1997, the Authority used \$58,978.04 of Low Rent Program funds to pay Port Holiday operating expenses. The Authority acquired Port Holiday Apartments from the Resolution Trust Corporation in 1994. The acquisition and operation was not part of HUD funded activities. Although HUD permits the Authority to use Section 8 Program Operating Reserves for other housing related activities, HUD does not permit the Authority to use Low Rent Program funds for such purpose. To meet Port Holiday expenses, the Authority used Low Rent funds to cover mortgage and insurance expenses. In 1996, the Authority used \$33,848.50 of Port Holiday funds to reimburse the Authority's Low Rent Program. Thus, at March 31, 1997, Port Holiday still owed the Low Rent Program a total of \$25,069.54.<sup>35</sup>

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## Recommendations

We recommend the Houston Office:

- 4A. Advise the Authority's Board and Executive Director in writing of the violation and instruct them to immediately cease using the Low Rent Program to support or otherwise subsidize ineligible activities;
- 4B. Require the Authority to repay the Low Rent Program from non-federal or Section 8 Operating Reserve funds the \$78,671 plus any additional amounts used after March 31, 1997, for similar purposes; and
- 4C. If the Authority continues to improperly use Low Rent funds or does not take prudent action to repay the

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35 The Authority sold Port Holiday Apartments subsequent to March 31, 1997.

Low Rent Program, take action to impose appropriate administrative sanctions against Authority Commissioners or Officers deemed responsible for the violations.

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## Employee Classification May Not Comply with the Fair Labor Standards Act

**The Authority has classified all of its administrative employees, regardless of job classification or description, as exempt from the overtime requirements of the Fair Labor Standards Act. The positions the Authority has classified as exempt include, but are not limited to: (a) secretaries; (b) housing inspectors; (c) cashiers; and (d) assistants. It appears the Authority relied on the general "administrative" organizational classification instead of following the more specific definition of the Department of Labor's regulations governing the exempt category for "administrative" employees. The routine and clerical type of duties performed by the majority of the Authority's administrative staff, do not appear to meet the "test" for an exempt classification. If the Authority improperly classifies its employees and does not compensate them for overtime work, the Authority is subject to retroactive claims for such compensation. Thus, the Authority needs to ensure it has properly classified its employees to preclude a potential liability for such compensation.**

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### Federal Requirements

Although HUD sets forth wage requirements for maintenance staff for overtime work, HUD does not have specific requirements for administrative staff. The implementing regulations for the Fair Labor Standards Act provide for employees to pay overtime for employees that work in excess of 40 hours per week (29 CFR Part 541). The regulations also provide exemptions from the requirement including an administrative employee exemption. However, as noted in a commercially published guide, the administrative exemption relates to the employees' duties rather than classification.<sup>36</sup> The guide makes a distinction between "production" duties (non-exempt) and "administrator" duties (exempt).

The Department of Labor has adopted both "long" and "short" tests for determining whether a given position qualifies for an administrative exemption. Employees who meet the criteria of either the long or short tests are exempt from receiving

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<sup>36</sup> The commercially published guide, "Public Employer's Guide to FLSA Employee Classification," Thompson Publishing Group, 1995, cites Department of Labor regulations and court cases to provide guidance in classifying employees as exempt or non exempt.

overtime pay under the white collar exemptions<sup>37</sup>. Criteria to qualify as an exempt administrative employee include duties:

- Requiring the exercise of discretion and independent judgment;
- Consisting mainly of office or non-manual work related to management policies or general business operations;
- Involving the direct and routine assistance of an executive or administrative employee in the performance of specialized or technical work requiring special training, experience, or knowledge;
- Requiring general supervision only; and
- That require spending 80 percent of the workday in above listed activities.

Guidelines indicate the Authority has misclassified administrative employees

The Authority's personnel policies (revised April 23, 1993), makes a blanket declaration that all administrative staff, no matter what their duties and responsibilities, are exempt from overtime under the Fair Labor Standards Act. However, individual employee job descriptions describing employee duties and responsibilities indicate that the positions should be classified as non-exempt. The Director of Personnel said when he assumed the duties of Personnel Director, the Authority had already adopted the personnel policy regarding employee classification. Further, he believed that the Authority properly classified all employees as administrative, and thereby exempt<sup>38</sup>.

To illustrate, the following positions, per their job descriptions, are not supervisory and do not require discretion and independent judgment:

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37 The Department of Labor tests for administrative, executive, and professional exemptions was published as an article entitled "The DOL Tests. . ."; from the Office of Commissioner, Department of Labor, as published in the Texas Business Today, January 1991. OIG obtained a copy of this article from the Authority's Director of Personnel.

38 Once the results of OIG's review were presented to the Director of Personnel, he agreed that the Authority would need to reclassify some of its administrative positions from exempt to non-exempt.



- Executive Assistant - stenographic and secretarial position involving the performance of delegated administrative duties for the Executive Director.
- Executive Secretary - provides clerical support necessary for front office operations and provides the public with informational assistance.
- Section 8 Administrative Assistant - provides clerical support necessary for front office operations and provides the public with informational assistance.
- Section 8 Housing Inspectors - conducts initial and annual inspections.

Both the Department of Labor's tests and the "Public Employer's Guide" note that a key factor in determining if the administrative exemption can be applied is the degree of discretion and judgment exercised by the employee. The Guide notes that in one recent court case, the court explained that the distinction between production and administrative employees is that employees whose primary duty is administering the business affairs of an enterprise are "administrators," and those who provide the commodity or commodities of the organization, whether that be goods or services, are "producers." The Guide states that in determining whether an employee is exempt under the administrative provisions, the employee must meet each and every requirement of the regulations, not just one or some of them. The Guide further notes that the Department of Labor regulations make a distinction between the application of knowledge and skill (non-exempt) and discretion and independent judgment (exempt).

To illustrate, the Guide cites recent court case law that decided the following jobs were not exempt positions:

- Probation officers and child treatment counselors were not administratively exempt because they did not perform work related to the management policies or general business operations of the employer and
- Television producers are production employees as are also insurance claim investigators.

Thus, it appears from the regulatory requirements and case law cited in the guide, that the Authority may have misclassified its employees as exempt. Although overtime worked by administrative staff during the audit period was minimal, two employees that should be classified as non-exempt worked overtime, but received compensatory time off in lieu of overtime wages<sup>39</sup>. However, the Authority, in the event it requires administrative employees to work overtime, could be subjecting itself to retroactive claims by the affected employees. Such claims, if cumulative, could result in adverse impact upon the Authority's financial position; thus, jeopardizing its ability to effectively carry out HUD programs.

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## Recommendations

We recommend the Houston Office advise the Authority:

- 5A. Of their potential liability if the Authority has misclassified any employees as exempt under the Fair Labor Standards Act and
- 5B. They should review their exempt and non-exempt classifications with legal counsel and take action to properly classify their employees and pay overtime when required by law.

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39 The employees who worked overtime but who received compensatory time off (during January 1994 through July 1996) were the Section 8 Administrative Assistant (93.25 hours) and the Executive Secretary (36 hours). Because of their classification as exempt administrative employees, overtime wages were not an option to them.

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# Internal Controls

**In planning and performing our audit, we considered the internal controls of the management of the Housing Authority of the City of Galveston, Texas, to determine our auditing procedures and not to provide assurance on internal controls. Internal control is the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal controls consist of interrelated components, including integrity, ethical values, competence, and the control environment, which includes establishing objectives, risk assessment, information systems, control procedures, communication, managing change, and monitoring.**

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We determined the following internal control categories were relevant to our audit objectives

- Procurement of goods and services
- Allocation and propriety of salary and other costs to federal programs
- Cash management practices
- Travel reimbursement, use of Authority vehicles and telephones
- Classification of administrative employees under the Fair Labor Standards Act

We evaluated all relevant control categories identified above, to the extent they impacted on our audit objectives, by determining the risk exposure and assessing control design and implementation.

A significant weakness exists if internal control does not give reasonable assurance the entity's goals and objectives are met; resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports.

## Significant Weaknesses

The Authority had significant weaknesses in the following management control categories:

- The Authority did not have an administrative system in place which ensures the procurement process complies with state, local, and HUD requirements (see Finding 1).
- The Authority did not have a system to ensure proper allocation of joint costs to its various programs (see Findings 2 and 4).

- The Authority did not have a cash management system to ensure it maximized investment income and timely used grant funds to meet obligations (see Finding 3).
- The Authority did not have a system in place to ensure it properly classified employees as exempt or nonexempt under the Fair Labor Standards Act (see Finding 5).

# Auditee Comments

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# Schedule of Ineligible and Unsupported Costs

Recommendation Number	Ineligible <sup>40</sup>	Unsupported <sup>41</sup>	Cost Efficiency <sup>42</sup>
1E		\$23,050	
2B		\$23,450	
2C	\$37,486		
2D			\$32,000
2G	\$490		
2H	\$393		
3A			\$70,000
4B	\$78,671		

<sup>40</sup> Ineligible amounts are not allowed by law, contract, HUD, or local agency policies or regulations.

<sup>41</sup> Unsupported amounts are not clearly eligible or ineligible but warrant being contested because of the lack of documentation supporting the need to incur such costs.

<sup>42</sup> A cost efficiency is an estimate of future savings from recommendations which prevent improper obligations, avoid more unneeded expenditures, or increased revenues.

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