audit report
OFFICE OF INSPECTOR GENERAL

Issue Date
October 24, 1997
Audit Case Number
98-FW-206-1001/1996-01376-01

TO: Steve Brewer
Acting Director, Office of Public Housing, 6APH

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

SUBJECT: Housing Authority of the City of Lubbock
Lubbock, Texas

As you requested, we have completed an audit of the Housing Authority of the City of Lubbock, Texas. The objectives of the audit were to: (1) evaluate the Authority's procurement administration; (2) determine whether funds were used for inappropriate activities; (3) ascertain the ownership of properties purchased from Resolution Trust Corporation; and (4) determine if income generated from the properties purchased from the Resolution Trust Corporation should offset the HUD operating subsidy. We have provided a copy of the report to the Housing Authority of the City of Lubbock.

Within 60 days, please give us, for each recommendation made in this report, a status report on: (1) 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 related to the audit.

If you or your staff have any questions, please contact Jerry R. Thompson, Assistant District Inspector General for Audit.

Executive Summary

At the request of the Director of the Fort Worth Office of Public Housing, we audited the Housing Authority of the City of Lubbock, Texas (LHA). The audit was to: (1) evaluate procurement administration; (2) determine whether funds were used for inappropriate activities; (3) ascertain the ownership of properties purchased from Resolution Trust Corporation; and (4) determine if income generated from the properties purchased from the Resolution Trust Corporation (RTC) should offset the HUD operating subsidy. As detailed in this report, the Authority did not follow sound procurement practices; it used grant funds for unauthorized activities; and it did not report income it earned on properties it purchased from RTC, thus, HUD overpaid the annual operating subsidy.

Authority pays contractors for work not done

The Authority paid three contractors $276,173 for work not done and $97,634 for work where we could not verify the propriety of the payment. In paying these contractors, the Authority did not follow even its own procurement policy. Management controls over conflict of interest and segregation of duties were ignored or lacking. Further, the Board of Commissioners did not perform a proper oversight role.

Grant funds mismanaged

The Authority: (1) overdrew $115,018 in HOPE I funds from HUD; (2) misused $128,684 in HOPE I funds; (3) misused $477,152 in Comprehensive Grant Program (CGP) funds; (4) misused CGP funds to pay salaries of workers to rehabilitate the LHA's non-low rent apartment complexes and the new office building; and (5) did not maintain sufficient documentation to support its draw downs from HUD for either the CGP or HOPE I Program. The misuse of funds resulted from management indifference, lack of management review, and management overrides of internal controls.

Unreported income affects HUD operating subsidy

From November 1993 through March 1997, the Authority did not report to HUD $1,967,511 in rent and lease revenues from non-low rent properties for Low Rent Program subsidy calculations. Thus, HUD most likely overpaid operating subsidy to the Authority.

Project sales proceeds misused

Despite agreements to the contrary, the Authority misused $379,216 in sales proceeds. HUD instructed the Authority to pay what it owed the Federal Financing Bank and to use remaining funds to purchase a new office building. The authority agreed. However, the Authority used most of the money for other purposes.

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The Authority provided us written comments and we discussed the audit with auditee officials at an exit conference on September 10, 1997. Authority officials generally agreed with our findings but stated that all of the problems can be directly connected to the previous management. We have included the Authority's comments in each finding and have included the response in Appendix B. However, we have not included attachments the Authority provided with their response. These are available for viewing at our office.

This report contains recommendations to recover $1,010,124 for ineligible payments and provide support for or repay $507,866 for questionable payments. We are also recommending that you ensure the Authority establish and comply with proper internal controls for its procurement activities and grant programs and that its Board establish an oversight system. In addition, the Authority should calculate the unreported income for each fiscal year and you should recalculate the annual operating subsidy. Also, if the LHA transfers properties to its nonprofit entity, you should ensure they are transferred at the current market value.

Introduction

A five-member Board of Commissioners, appointed by the Mayor of the City of Lubbock, governs the Lubbock Housing Authority (LHA). The Board hires an Executive Director to manage the LHA's day-to-day operations. During the audit period, Mr. Oscar Sharp was the Executive Director until he resigned on July 15, 1996. The Board appointed Mr. Quincy White as Interim Executive Director just prior to Mr. Sharp's resignation and as Executive Director after Mr. Sharp resigned.

The LHA was established in 1939. The LHA completed construction of its first project, Hub Homes, project TX018001, in 1941. This project included 130 units. The project was financed with 60-year notes. The LHA completely vacated this project in 1993 and subsequently demolished the units. The LHA sold the Hub homes property on August 10, 1995. The LHA currently administers 633 low-rent units consisting of the following:

Project	**Project Number**	**No. of Units**
Greenfair Manor	TX018002	236
Turnkey III	TX018003	14
Single Family Dwellings	TX018004	60
96 West/36 South	TX018005	132
Behner Place I	TX018006	36
Behner Place II	TX018007	46
Mary Meyers Seniors	TX018008	48
Cherry Point	TX018009	61
TOTAL		**633**

In addition to the low-rent projects, the LHA administers 383 Section 8 certificates and vouchers, and 36 Section 8 moderate rehabilitation units. Also, since 1993, the LHA acquired five additional projects consisting of 170 non low-rent units and a downtown office building from the Resolution Trust Corporation (RTC).

In January 1993, the LHA incorporated a non-profit public benefit corporation, City of Lubbock Housing Initiatives. The Articles of Incorporation state the corporate purpose is to provide affordable housing for the economically disadvantaged citizens; to maintain decent, safe, and sanitary housing; to subsidize low-income rents; to alleviate homelessness, substandard housing, etc; and to restore a sense of community pride, self esteem, and participation in the quality of life. The corporation managed the properties purchased from RTC.

In 1992, HUD awarded the LHA $6 million in Comprehensive Grant Program (CGP) funds for use over a 5-year period. The Authority was to use the funds for modernization at the low-rent projects.

In May 1994, HUD approved $1.75 million in HOPE I funding. The Authority was to rehabilitate and sell 121 of the Authority's units to low-income residents. In October 1996, HUD approved the reduction of the number of units to 50.

The address of the Lubbock Housing Authority's main office is 1301 Broadway, Lubbock, Texas, 79401.

Audit Objectives

We conducted our examination of the Housing Authority of the City of Lubbock to: (1) evaluate its procurement administration; (2) determine the amount of funds used for inappropriate activities; (3) ascertain the ownership of properties purchased from the RTC; and (4) determine if income generated from the properties purchased from the RTC should offset the HUD operating subsidy.

Scope and Methodology

We initiated the audit based on the problems identified by the HUD Field Office in its monitoring reviews. To achieve the audit objectives we examined HUD program and financial records, legal documents to include contracts and waivers, and monitoring reports. At the LHA office we examined legal, program, and financial records for the low-rent and grant programs and the LHA's "non-profit entity". We obtained paid invoices to identify work purportedly done or items received and visited the sites and inspected the items invoiced. We interviewed HUD employees and current and former LHA employees. We also interviewed LHA residents, former and current contractors, vendors, Board members, and other parties that had an interest in the LHA's activities.

The audit generally covered the period of October 1, 1993, through May 31, 1996; we extended the coverage, as appropriate to examine current procedures in use. We performed the audit field work primarily at the LHA offices in Lubbock, Texas, and the HUD office in Fort Worth, Texas. We performed the audit between January 1996 and May 2, 1997, in accordance with generally accepted government auditing standards.

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Abbreviations

CDBG	Community Development Block Grant
CGP	Comprehensive Grant Program
CLHI	City of Lubbock Housing Initiatives, Inc.
HOPE	Housing Opportunity for People Everywhere Program
HUD	U. S. Department of Housing and Urban Development
OIG	Office of Inspector General
PHA	Public Housing Authority
RTC	Resolution Trust Corporation

Authority Pays Contractors for Work Not Done

The Lubbock Housing Authority (LHA) paid three contractors $379,820 for work not done or identifiable, and wasted another $38,100 due to poor planning. The LHA did not follow its own procurement policy. LHA personnel involved with procurement allowed their own companies or contractors with whom they had close relationships to do contract work for the LHA. In addition, the same personnel approved payments to contractors. The LHA Board did not provide proper procurement oversight because it did not require and review any procurement and payment data during the period. With such reviews, the Board could have identified problems and required corrective action.

Criteria

Title 24, Code of Federal Regulations (24 CFR), Section 85.36(b)(1) requires housing authorities to follow their own procurement procedures. The procedures must reflect applicable state and local laws and regulations provided the procurement conforms to applicable federal law and standards identified in 24 CFR, §85.36. Section 85.36(b)(3) requires the LHA to have a written standards of conduct governing the performance of employees engaged in the award and administration of contracts. The LHA's procurement policy states that it includes the procurement standards of 24 CFR,§85.36.

Section 306 of Part II of the Annual Contribution Contract dated September 17, 1976 required the LHA comply with all applicable state and local laws. It also required the LHA to make material and supply purchases and award repair and maintenance contracts only to the lowest responsible bidder after advertising requests for proposals.

Section 5 of Part A of the LHA's new Annual Contribution Contract dated October 12, 1995, requires the LHA to comply with all statutes and regulations issued by HUD including those regulations promulgated by HUD at 24 CFR. The LHA shall ensure compliance with such requirements by any contractor engaged in the development or operation of a project covered under the ACC.

Before HUD provides comprehensive grant funds, it executes an amendment to the Annual Contribution Contract. The amendment states that the funds will be used to help finance improvements to existing low-rent projects and for upgrades to project management and operation.

The LHA's procurement policy states: the executive director will ensure that procurement requirements are subject to an annual planning process; the planning process will assure efficient and economical purchasing; the LHA will prepare written contracts and modifications and clearly specify the desired supplies, services, or construction. The policy also states that contract files will contain adequate documentation to support the procurement method chosen, the type of contract selected, the rationale for selecting or rejecting offers/bids, and the basis for the contract price. The policy requires an independent cost estimate before solicitation issuance and a cost analysis of the responses received for all procurement. For purchases of $15,000 and over the policy provides for sealed bidding procedures. The procedures include solicitation and receipt of bids, a bid opening/award, and bonding requirements. The policy is to award contracts to the responsive and responsible bidder offering the lowest price. Sealed bidding is the preferred method for construction procurement. The policy is to inspect and accept the work before payment. The procurement officer is required to maintain records sufficient to detail a procurement history. Also, the officer is to insure that contractors satisfy the requirements of their contracts.

The policy stipulates that no employee, officer, or agent will participate in the selection or award of any contract if a conflict, real or apparent, would be involved. Such conflict arises when a financial or other interest in an entity selected for the award is held by: (1) an employee, officer or agent involved in making the award; (2) his/her relative; or (3) his/her partner.

LHA made payments totaling $379,820 for work not done or not identifiable

The LHA paid three contractors grant funds totaling $276,173 for work (labor only) not done and $97,634 for work where we could not verify the propriety of the payment. (Total payments to these three contractors amounted to $676,555.) The LHA did not advertise and obtain bids or execute contracts for the work on cabinets, windows, doors, miniblinds, and painting. Based on the invoices, we identified and inspected the location of the work purportedly completed. However, our inspections showed no work completed for work amounting to $276,173 of the $676,555 invoiced. We could not verify the propriety of the payments amounting to $97,634 because: (1) the location of the work was not identified on the invoice or any other documentation or (2) the eligibility of the grant expense could not be determined. So, we could not verify eligible work was actually done.[1]

The LHA overpaid one contractor grant funds totaling $6,013 because of duplicate payments and math errors on invoices. The LHA made many payments based on copies of invoices approved for payment. The LHA officials realized they had made duplicate payments and obtained refunds for most overpayments. However, the LHA had not identified these overpayments. The LHA should rarely issue a payment based on an invoice copy, but if a copy is approved for payment, responsible LHA personnel should confirm that the LHA received the invoiced item. Also, the LHA should review previous payments to the payee to decide whether the current authorized payment is a duplicate. We included the details of the $6,013 payment on the separate schedule provided to the LHA.

Lack of procurement planning causes waste

The LHA also wasted $38,100 in comprehensive grant funds by purchasing excessive materials for a fence. HUD approved the LHA's 1992 CGP budget that included the building of a fence at the Greenfair property. The LHA did not document any plans, specifications, or a cost estimate for the fence. The LHA did not document that it considered whether the job should be done on a turnkey contract basis or with force account labor. Without explanation, the LHA used force account labor to construct the steel and stucco fence. The LHA hired welders as part of its force account crew to build the fence. The LHA advertised and on March 3, 1993, received bids for 4,200 20-foot 3/4-inch square steel rods and other steel items. The lowest bid by a responsible vendor was $71,930.

1 We provided the LHA and HUD's Office of Public Housing a separate schedule that identifies the contractors, work items and amounts, invoices and check payments.

On March 17, 1993, the LHA purchased from a local vendor 8,400 20-foot 5/8-inch square steel rods (about $52,600) and other steel items at a total cost of $89,440. The purchase included a jig for use in constructing 10-foot fence sections. The LHA did not document why it changed the size and quantity of the steel rods, why it changed the procurement method, or why it did not use competitive bidding for the final procurement. The finished "security" fence is poorly constructed and gives the property the appearance of a prison (see photograph on page 7).

In August 1993, the LHA paid the same vendor $73,600 to obtain an additional 8,400 20-foot 5/8-inch square steel rods (about $52,600) and 12,000 finials (about $21,000).[2] Both the initial and the second steel purchases were delivered to a fenced area that the LHA leased with the warehouse. In April 1997, the LHA still had approximately 2,740 unused 20-foot 5/8-inch square steel rods ($17,100) at the delivery location (see photograph on page 7). In addition, the LHA had the jig and small amounts of other steel items at the location. The LHA stored the 12,000 finials, still in boxes, inside the leased warehouse. Besides the construction cost of the poorly built and ill-conceived fence, the obvious waste by the LHA includes:

- $17,100 spent for excessive steel rods;
- $21,000 spent for the 12,000 unused finials;
- the loss of value on the steel rods because of the deterioration;
- the potential loss of value on the finials that were not returned; and
- the additional cost for the LHA to lease the enclosed lot for 3 years to store the excess steel.

2 Finials are small cast iron decorative tops for the rods.

Unpainted and rusting fence.

Excess steel after fence installation.

LHA did not follow its procurement policy and procedures

The LHA did not follow its own procurement policy. The policy guidelines are adequate for ensuring that procurement and payment for work can be obtained at a cost beneficial to the LHA. The LHA maintained little documentation that was required by its policy. Therefore the LHA could not ensure that work was properly solicited and awarded. The LHA paid at least 13 contractors amounts for construction work that exceeded the threshold that would require the LHA to award the contracts based on its biding procedures. However, only two contract files had documents to show that bidding procedures were used to award the work and to prepare written contracts. Generally, the LHA did not: (1) prepare either written contracts or adequate work specifications to ensure contractor performance at a specified level; (2) document why it selected specific contractors for particular work; (3) document why the contractor provided only labor when the amount paid was adequate for the labor and materials to complete the work; and (4) make inspections of the work or did not document the inspection results before paying the invoices.

The LHA also did not follow the standards of conduct guidelines in its procurement policy. The personnel involved in procurement activities directed work to either their own companies or contractors they were closely related to. The frequency that LHA personnel or their companies worked as contractors for the LHA shows a wide-spread acceptance by management to ignore the LHA's procurement policy provisions relating to conflicts of interest.

The LHA used a company directed by the former HOPE I coordinator. The company used and paid LHA personnel as contract laborers to work on HOPE I houses after regular LHA work hours. In addition, the former CGP coordinator either owned or had a close relationship with three of the companies/contractors that we mention in this finding. Additionally, the LHA paid the suppliers directly for all the materials and equipment charged to the LHA by these companies/contractors. The LHA lacked control or accountability to ensure the materials and equipment obtained in this manner benefited the LHA.

The LHA did not maintain inspection reports that showed the required work was completed and accepted before the LHA paid the contractor. The former CGP administrator just initialed the invoice to approve payment by the LHA. The former CGP administrator approved invoices for payment for CGP, HOPE I, and Low Rent Programs. The former CGP administrator also designated on the invoices the specific accounting codes to classify costs to the various programs and program activities.

Procurement practices have not improved sufficiently with recent management changes

Although management has changed, the LHA's procurement practice has not satisfactorily improved. In October 1996, the LHA established a position for and hired a procurement officer. We reviewed the procurement activities that occurred from October 1996 through April 10, 1997, to find out if the LHA procurement activity improved. The LHA did not document its procurement files with sufficient information to show the history for specific procurement. The LHA used bidding procedures for construction work. However, it awarded work to the highest bidder without documenting sufficient justification for the decision. After the LHA announced the contract awards for the remodeling of three houses, the LHA contracted with three different contractors for the work to be done. The LHA did not document why the change was made or why the contracted work was not readvertised and rebid. The LHA paid for change orders listed on the contractor's invoice without documenting the need or approvals of the change orders before the work was done. The LHA did not obtain valid inspection reports for completed work before paying the contractor. However, the LHA did prepare written contracts and set time limits for the work completion. The procurement officer resigned from the position April 30, 1997. On April 7, 1997, the LHA hired another person for the position. This person also resigned on May 9, 1997. Thus, the LHA's procurement problem has not yet been corrected.

Auditee Comments

LHA officials said they agree with most of the finding. They said the previous, not the current, administration was responsible for the problems cited. The previous administration did not advertise and obtain bids or execute contracts on cabinets, windows, doors, miniblinds, and painting. Procurement policies and procedures were not followed. Proper documentation was not available for the work items where we could not verify the propriety of the payment. The excessive waste associated with the fence was the result of a combination of poor procurement planning, an incompetent labor force, and a lack of architectural expertise.

LHA officials contended that certain work classified as work not done should be identified as work not verifiable and that they have improved the implementation of procurement policies and procedures since May 1996. The majority of the work not done should be reclassified as not verifiable because high vandalism rates in the areas prohibit the ability to physically verify work performed several years ago. They said $12,328 identified as work not done was actually done. They said LHA procurement practices since May 1996 have improved significantly. They said procurement history documentation such as approved change orders and inspection reports were prepared and are currently in the files. They said our audit work in this area was incomplete since it dealt with only one example. A confirmatory review conducted on June 2, 1997, by the Facilities Management Division of HUD's Fort Worth Office states:

> "During the site visit, a random sample of procurement activities were selected to determine whether the HA is following regulations. Each procurement took place in 1997. The review notes that the HA is meeting the procurement regulation and that there are adequate controls in place. However some improvement is needed to ensure that the procurement records are centrally located. Due to your HA's improvement in this area, your score of C on indicator #2 Modernization, Component #3 Contract Administration, has been changed to a score of A."

The LHA officials said the current management initiated procedures and policies to cure many of the deficiencies cited. Force account labor is no longer used. Also, they initiated proper bid procedures to award contracts to private contractors. They hired an experienced procurement officer to set up the department. Also, the current management reviewed and revised procurement policies and the Board of

Commissioners approved them. A report of procurement activities is presented in every monthly Board of Commissioners meeting.

OIG Evaluation of Auditee Comments

Because some Board members and LHA staff served the entire audit period, we did not attempt to place responsibility for all the identified problems on particular "administrations."

At the exit conference on September 10, 1997, we presented the LHA with additional documentation to show that $10,203 of the $12,328 with which the LHA disagreed, was in fact work not done. In addition, we agreed that $1,125 of the $12,328 we identified as work not done was actually done. We incorporated this change into the audit report.

Although some procurement changes were made, the LHA's overall procurement practice did not improve sufficiently during the period reviewed. The Fort Worth HUD Office raised the LHA's score for contract administration (modernization area) from C to A. However, HUD personnel stated that the high score was the result of the LHA's improvements on its award process and was based on HUD's review of only three contracts. The score was not indicative of the LHA's procurement administration from award through work completion and payment. HUD staff stated that for the three contracts reviewed the LHA had difficulty finding the documents to support its actions. The documents were not filed in the appropriate contract folders.

Recommendations

We recommend that HUD require the LHA to:

1A. Ensure that proper procedures are in place and complied with for adequately recording a procurement's history, to include procurement needs planning, the selection of the type of procurement, good written work specifications, advertising for and receiving bids, awarding the contract, written contracts with specific time limits for work completion, adequate completion of work inspections, approvals for payment, and scrutiny of invoices;

1B. Repay the grant programs from non-federal funds (a) the $276,173 paid to the contractors for work not done; (b) the contractor overpayment of $6,013; and (c) the $38,100 wasted on the purchase of excess fence items;

1C. Provide support for the questionable expenditures totaling $97,634 where the propriety could not be verified. HUD should require the LHA to repay the grant programs those amounts for which the LHA cannot provide adequate support documents to decide the eligibility of cost to the grant;

1D. Establish a system to ensure proper Board oversight of procurement and contracting activities; and

1E. Use its civil remedies to recover funds. Also,

1F. We recommend HUD sanction appropriate LHA management officials who ignored the Authority's procurement policies.

Grant Funds Mismanaged

The Authority: (1) drew from HUD $115,018 more than the amount of HOPE I expenditures; (2) used $128,684 of HOPE I funds to pay non-HOPE I Program costs; (3) used $477,152 of Comprehensive Grant Program (CGP) funds to pay non-CGP costs and costs we could not verify as appropriate CGP charges; (4) used CGP funds to pay salaries of workers to rehabilitate the LHA's non-low rent apartment complexes and the new office building; and (5) did not maintain sufficient documentation to support its draw downs from HUD for either the CGP or HOPE I Program. The LHA lacked adequate internal controls to manage its grant funds properly. The lack of internal controls resulted from management indifference, lack of management review, and overrides of controls by management officials. Consequently, grant accomplishments were deficient.

Criteria

Part Two of the Consolidated Annual Contributions Contract dated September 17, 1976, Section 309, requires the LHA to maintain complete and accurate books of accounts and records.

Section 5 of Part A of the LHA's new Annual Contribution Contract dated October 12, 1995, requires the LHA to comply with all statutes and regulations issued by HUD including those regulations promulgated by HUD at 24 CFR. Section 15 requires the LHA to maintain complete and accurate books of accounts and records.

Title 24, Code of Federal Regulations (24 CFR), Subtitle A, Appendix A, Section 510(a), states that policies, guidelines, and requirements of 24 CFR, part 85, and OMB Circular No. A-87, Cost Principles for State, Local and Indian Tribal Governments, apply to the HOPE I Program.

Title 24 CFR, Part 968 applies to the Public Housing Modernization Programs. Section 968.101 states that HUD provides CGP funding to the LHA to improve the physical condition and upgrade the management and operation of existing public housing developments for low income families. Title 24 CFR, §968.110 states that 24 CFR 85, requiring the use of OMB Circular No. A-87, applies to the CGP.

Title 24 CFR, §85.20(a)(3), requires the LHA to have effective controls and accountability of grant cash and other assets. Section 85.20(6) requires the LHA to have accounting records supported by source documents, e.g., checks, paid bills, payrolls, time and attendance records, etc. Section 85.20(7) requires the LHA to minimize the time elapsing between the transfer of funds from the U. S. Treasury and disbursement by the LHA. Section 85.20(a)(5) requires that OMB cost principles, agency program regulations, and the terms of the grant be followed in deciding the reasonableness and allowability of costs. Section 85.21(f)(2) requires the LHA to disburse program income before requesting an additional draw of grant funds.

OMB Circular No. A-87, Attachment A, paragraph A.2. states the LHA is responsible for the efficient and effective administration of its grant programs through application of sound management practices. Paragraph C.1.a. states that costs, to be allowable, must be necessary and reasonable for proper and efficient administration of the program.

Excessive draws made for grant programs

During the period of October 1, 1994, through September 30, 1996, the LHA drew from HUD $115,018 more than it spent on its HOPE I Program. According to the LHA's HOPE I general ledger, the LHA drew $1,044,269 from HUD, but HOPE I cash transactions were only $929,251. The LHA drew more than its HOPE I Program costs because it needed cash for other on-going activities.

LHA lacked sufficient controls over its programs

The LHA drew down funds in excess of amounts needed to cover current grant expenditures and used grant funds for unauthorized purposes. LHA management officials did not establish and enforce sufficient controls to ensure that grant funds were used only for authorized grant purposes. The LHA officials did not always: (1) draw down grant funds timely to cover program costs; (2) properly account for the spending of its grant funds; (3) ensure that the costs it charged to the grant program were for grant purposes; or (4) maintain support documents for all transactions, e.g., draw downs, payroll, journal voucher entries, etc. Further the LHA Board of Commissioners did not provide proper oversight and control of the LHA's activities. The Board did not require and review sufficient accounting reports and data for the individual programs.

We reviewed the October 1996 payments related to the HOPE I Program to decide if the excess funds were needed. The LHA did not need the funds for its HOPE I Program. From September 1, 1996, through December 31, 1996, the LHA sold eight of the HOPE I houses and generated HOPE I program income of $92,151. A local bank financed the buyer's loan on seven of the eight house sales. Therefore, the LHA received the proceeds on these sales immediately. The LHA financed the loan on the eighth house. The LHA deposited the proceeds of the sales into a separate bank account. If the LHA operates the program as it was designed, the LHA will sell more houses and generate additional program income. The HOPE I guidelines require the LHA to offset on-going program costs with its program income before drawing additional HOPE I funds.

LHA officials were aware of the problem with overdrawing grant funds. The former finance director attached a note to the first draw request of the LHA's 4th year Comprehensive Grant stating that the draw was excessive by $36,701. The draw was excessive because the LHA had not incurred sufficient costs to support the amount requested from HUD.

During our review of the CGP and draw downs, we noted that documentation to support the validity of the request was inadequate. Often the LHA kept only a printout of the general ledger transaction instead of the transaction document that showed the validity of the program expense.

HOPE I and Comprehensive Grant Program funds used for unauthorized purposes

The LHA used $128,684 in HOPE I grant funds and $66,920 in CGP funds for unauthorized purposes. Also the LHA used $426,975 in CGP funds that we could not determine whether the funds were used for authorized grant purposes.

> During the period of October 1, 1994, through September 30, 1996, the LHA spent HOPE I funds totaling $128,684 for non-HOPE I Program activities. The $128,684 is 13.8 percent of the LHA's total HOPE I charges of $929,251 for the period. The unauthorized charges included: items purchased for use on other programs, duplicate charges, payroll expenses and related payroll costs of other programs, and indirect administrative costs (including a portion of the executive director's salary) arbitrarily charged. The largest portion

of these costs related to payroll ($53,424) and related payroll charges ($16,141). A portion of these payroll charges occurred because the LHA chose to pay its CGP force account crew with HOPE I funds for a short period. The former finance director instructed the payroll staff to charge the payroll costs for security and CGP force account personnel to the HOPE I Program. She explained that the executive director approved the action because HUD had not approved and released funding for the CGP. We are providing the LHA and the HUD Office of Public Housing a separate schedule that identifies the details of these transactions.

The LHA used CGP funds to pay workers to remodel the office building and its non-low rent apartment complexes purchased from the RTC. The LHA did not add the six apartment complexes to its Annual Contribution Contract with HUD as low-rent projects. Since they were not low-rent projects, the force account labor and labor related costs paid from the CGP were inappropriate CGP costs.

The LHA's time keeping records for force account workers could not be relied on to accurately determine the cost objective to be charged. The payroll sheets did not always include the work site for the worker. Current and former LHA personnel confirmed that the LHA's time keeping records were not accurate. A former finance director requested the former executive director to allow the LHA to change the time keeping system. The finance director stated the records should show the work site for each worker so the LHA could charge the cost to the appropriate program. The former executive director did not want the system changed.

From October 1, 1993, through September 30, 1996, the LHA spent CGP funds totaling $477,152 to pay for non- CGP activities ($66,920) and costs that we could not verify as appropriate for the grant ($410,232). The amount may be higher because we based our calculation on a review of the draw down support documentation. We included only costs that the support documents clearly showed the costs to be for non-CGP activities or costs for activities we could not verify as an approved grant activity. We are providing the LHA a separate schedule that identifies the details of the specific transactions.

The $66,920 of CGP charges for non-CGP activities included the following:

CGP Funding	Amount	Actual Purpose
701	$ 5,373	LHA's non-low rent apartment complex
701	25	Maintenance item-Mary Meyers units
702	20,109	LHA's non-low rent apartment complex
703	8,525	Invoiced work not done (besides that identified in Finding 1)
703	24,845	LHA's non-low rent apartment complex
703	2,913	Section 8 expense
703	720	Consultant-to write grant application for Youth Build
703	4,410	Contractor expense for his equipment rental
TOTAL	$**66,920**	

The program costs of $410,232 that we could not verify as appropriate for the grant were for the following items:

CGP Funding	Amount	Actual Purpose
701		Remodeling of new LHA office building
702	$ 30,259	Remodeling of new LHA office building
703		Copiers purchased (identified by serial
	10,375	number) that we did not find
703		Remodeling of new LHA office building
703	15,359	Refrigerators purchased from a contract supplier
	350,479	
	3,760	
TOTAL	$**410,232**	

The CGP budget approved by HUD did not include the use of CGP funds to remodel the new office building. If HUD took any action to allow the cost for the grant program then HUD's action was after the LHA obtained the building and completed most of or all the work. The LHA leases a large portion of the building to business and government entities. The costs to demolish and remodel the areas not used by Low Rent are not appropriate CGP charges. In February 1997, HUD and the

LHA agreed that the LHA's Low Rent Program owns the building.

Grant accomplishments are wanting

According to the accounting records, as of April 23, 1997, the LHA spent over $1.9 million for improvements in the Cherry Point Addition and $1.27 million for improvements at the Greenfair project. These amounts include over $1 million questioned as spent for other purposes in this finding and in Finding 1. Obviously, if the amounts shown in the accounting records had been spent on the projects, much more progress would be evident in accomplishing the purpose for which the money was approved.

As of April 1997, the LHA had spent about $875,000 of the $959,300 in CGP funds that HUD approved since October 1992 for improvements to be made on the Cherry Point Addition. Also, the LHA had drawn down $1,044,269 of the $1.75 million in HOPE I funds HUD had approved in late 1994 for the LHA to rehabilitate and sell the 121 single family houses to low income residents. In December 1996, at the LHA's request, HUD reduced the number of houses the LHA must sell under the HOPE I Program to 50.

The 3 projects in the Cherry Point Addition have 135 houses. Fourteen of the houses are under the Turnkey III Program occupied by buyers under the program who contribute to a maintenance reserve account. Of the remaining 121 houses, there are 17 vacant houses. This is a 14 percent vacancy rate in these projects. The 17 vacant houses are in addition to the vacant units with on-going rehabilitation work under the HOPE I Program. The LHA has boarded up vacant houses to reduce vandalism. However, only eight houses had been rehabilitated and sold as of April 25, 1997, although the HOPE I Program has operated for over 2 years. The LHA had qualified 16 additional families (5 seniors) for house loans and was either remodeling or closing the house sales for these 16. From February 12, 1997, through April 3, 1997, the LHA awarded contracts to rehabilitate 11 houses.

At the Greenfair project, the LHA had spent grant funds totaling over $1.27 million approved for project improvements during the last 4 years. The Greenfair project has 236 units: 228 for low-income tenants and 8 for non-dwelling purposes such as security, community center, non-profit entities, etc.

As of April 1, 1997, the project had 128 vacant dwelling units, a 56 percent vacancy rate. The LHA had spent some CGP funds on many vacant units that still are not suitable for housing tenants. The vacancy rate has continued to rise. The LHA has boarded up the vacant units to reduce vandalism.

Auditee Comments

LHA management said they generally agree with the finding. However, they said the current Board of Commissioners did not fail to provide proper oversight and control of LHA activities. The Board of Commissioners of the LHA changed completely in January 1994. None of the prior members were reappointed. The newly appointed members lacked functional knowledge and training so it was difficult to provide effective oversight. The prior Executive Director oriented, advised, and warned the newly appointed Board that they could make "only policy decisions" and could not become involved in the daily operations of the LHA. The former Executive Director assured the Board that everything was being handled properly.

In 1996 only two of the five Board members were reappointed. In April 1996 HUD provided the Board the results of its technical review. The report clearly showed that the former Executive Director was not handling matters properly. The Board initiated actions to remove the former Executive Director who subsequently resigned.

LHA management was not clear how the sales proceeds from HOPE I houses could be used. Therefore, they requested that the Fort Worth HUD Office allow them to use the proceeds to purchase a 50-unit elderly complex to offset the loss in inventory. They requested the subsidy from the 50 HOPE I units be transferred to the 50-unit elderly complex that they would purchase. HUD staff said they could purchase an elderly complex with the sales proceeds; but they have not received an answer on the subsidy transfer.

LHA officials said the current management provides the current Board monthly financial and operational reports on each department. Further, they said the current Board is very active in the oversight of LHA business.

OIG Evaluation of Auditee Comments

The LHA's response further supports our position that the Board did not provide proper oversight and control of the LHA's activities. In addition, the Fort Worth HUD Office has not provided a waiver for the use of the sales proceeds from the HOPE I houses. HUD personnel received the LHA's request and are considering a possible waiver for the purchase. If HUD allows the LHA to purchase a 50-unit complex, the units will be added to the LHA's Annual Contribution Contract to replace the 50 units being sold under the HOPE I Program. As of October 6, 1997, HUD had not provided the LHA the waiver.

Recommendations

We recommend that HUD require the LHA to:

2A. Put adequate controls and procedures in place for the proper administration of the programs. This should include a system that provides:

1) Adequate oversight by the Board to preclude management override of Board adopted procedures and controls;

2) Periodic Board evaluation of the benefits received by the LHA and its low-rent tenants for the funds spent;

3) Accurate classification and accounting for program funds and charges;

4) Draw of grant funds limited to the amount needed for the timely payment of grant charges; and

5) Documentation maintained to support the accuracy and validity of the various transactions and entries;

2B. Repay HUD the $115,018 in excessive HOPE I Program draws;

2C. Repay the grant programs the $128,684 of HOPE I funds and the $66,920 of CGP funds that the LHA spent for non-grant activities;

2D. Provide support for the CGP expenditures of $410,232 where the propriety of the costs could not be decided, i.e., the remodeling of the new office building and the equipment that could not be located, and repay the grant programs those amounts for which the LHA cannot provide adequate support documents to decide whether the payment was an eligible cost for the specific grant; and

2E. Determine the amount of labor and labor-related benefits of the force account personnel when they worked at the LHA's five non-low rent properties and the new office building, and repay the CGP for amounts paid for work that HUD did not approve as CGP activities.

Unreported Income Affects HUD Operating Subsidy

From November 1993 through March 1997, the LHA did not report $1,967,511 rent and lease revenues from non-low rent properties. The LHA intended for its non-profit organization to own the properties and accounted for rental and lease revenues received from the non-low rent properties separately from the Low Rent Program. However, the LHA used its own funds to purchase and rehab the properties and therefore owned the properties. Consequently, because it owned the properties, it should have reported the revenues, which would have affected HUD's calculation of the operating subsidy.

Criteria

Title 24, Code of Federal Regulations, §990.104, states how the amount of operating subsidy is determined for public housing authorities (PHAs). The amount is calculated by subtracting the total expense level from the projected operating income level. Section 990.109(e)(3) states the projected operating income level will include the PHA's estimate for other income.

HUD Handbook 7475.13, Performance Funding Handbook, paragraph 4-5, provides that in the calculation of operating subsidy eligibility, a public housing authority must include an estimate of "other income" based on its past experience and a reasonable projection for the requested budget year. "Other Income" includes profits or other revenues from the operation of other PHA enterprises (e.g., management of Section 8 or non-HUD-assisted housing projects, commissions, and profits from vending machines) unless:

(a) There is a complete and proper allocation of all expenses to such enterprises, including wages and salaries;

(b) The accounts of such enterprises are maintained separate for the public housing program; and

(c) Equipment and facilities (e.g., computers) acquired from public housing funds (e.g., Comprehensive Improvement Assistance Program funds) are not used substantially for the operations of such enterprises.

Title 24, CFR, §990.110 provides for adjustments in the amount of operating subsidy. Paragraph (g) of this section provides that HUD may at any time make an upward or downward adjustment in the amount of the PHA's operating subsidy as a result of data subsequently available to HUD which alters projections upon which the approved operating subsidy was based.

Non-low rent properties and related income belong to Low Rent Program

The Fort Worth HUD Office of Public Housing decided and the LHA agreed, in April 1997, that the properties purchased from RTC belong to the Low Rent Program. As discussed in this finding, the LHA's non-profit entity did not have any start-up funds. Also, the LHA used low rent funds to purchase, remodel and operate the properties. Thus, the properties and all income generated from the properties belong to the Low Rent Program. We agree with this determination. In addition, we believe the operating subsidies need to be recalculated for the periods the properties were operating without the income being reported to HUD.

Authority owns properties

In an April 1, 1997 letter from the Fort Worth HUD Office of Public Housing to the LHA Executive Director, HUD stated the LHA purchased and possibly rehabilitated an office building and non-low rent apartment complexes with LHA funds instead of the nonprofit's funds. Questions have been raised about the legality of the LHA's nonprofit corporation. The LHA intended for the non-profit to own these properties. HUD and LHA management agreed that the properties and the earned income belong to the LHA's Low Rent Program. The LHA could transfer the properties to the nonprofit at some time in the future. But the LHA must repay the LHA funds used in the purchase and rehabilitation. If the LHA decides not to transfer the properties, it still would have to repay the program accounts (i.e., CGP, etc.) the funds it used in the purchase and rehabilitation.

Non-low rent apartment income not reported

The LHA did not report to HUD the rental and other income that it received from its non-low rent apartment complexes. From November 1993 through March 1997, the LHA collected rent and other revenues totaling $1,796,168 from these apartments. The LHA deposited the funds in a separate LHA bank account. Also the LHA accounted for the revenues on books and records separate from the Low Rent Program. The LHA did not include revenue amounts in the data reported to HUD. As stated in Finding 2 the LHA used grant funds for remodeling and maintaining these apartments. The LHA also used low rent funds for purchasing these apartments.

Low Rent Program funds used to purchase non-low rent apartments

In September 1992, the Board approved negotiation with the Resolution Trust Corporation (RTC) for the purchase of three apartment complexes. The LHA proposed to purchase two properties, and then enter a partnership with the City of Lubbock under the City's Self-Sufficiency and Homeless Programs. The LHA would purchase the third complex as an investment so the LHA could build up its reserve. The Board then established a non-profit management branch, City of Lubbock Housing Initiatives, Inc. (CLHI).

In February 1993, the Board approved negotiations with RTC to purchase other properties as they become available. In October 1993, the Board approved the purchase of three apartment complexes from RTC for specific prices.

The CLHI would administer the properties for use by low to moderate income families through the social services and self-sufficiency programs. The LHA would set up these programs at the properties. The LHA prepared Articles of Incorporation for the CLHI that required the assets remaining after debt repayment and expenses be distributed to the LHA's Low-Income Housing Programs.

The Board established the CLHI without providing it any start-up cash. Thus the CLHI lacked cash and credit to make the purchases. The LHA purchased the properties in its own name. It used low rent and low rent related funds for downpayments, settlement closing costs, remodeling and operating expenses. Also the LHA received $500,000 in CDBG funds through the City to help in the remodeling of two of the complexes. On July 11, 1995, and September 12, 1995, the LHA refinanced the note balances on these three properties. The two refinanced bank loans exceeded the original note pay-offs. This allowed the LHA to take out about $500,000 cash. The LHA placed $250,000 of the cash into the low rent account and the remainder in certificates of deposit for the CLHI. The LHA purchased three additional smaller apartment complexes from RTC. The following shows the properties, dates of purchase, prices, and sources of funds for each purchase and refinancing.

PROPERTIES PURCHASED				
Property Location	**Settlement Date**	**Purchase Price**	**Loan Amount**	**Cash from LHA**
4303 19th St.	10/29/93		$428,670	$ (712)
4406 20th St.	10/29/93	$433,000	165,231	2,509
4407 20th St.	10/29/93	166,900	147,510	2,120
1909 5th St.	7/14/94	149,000	-	30,239
709 Ave. R	7/14/94	30,000	-	45,223
2217-9 5th St.	11/30/95	45,000	-	40,816
		41,375		
TOTALS		$**865,275**	**741,411**	$**120,195**
PROPERTIES REFINANCED				
Property Location	**Refinance Date**	**Pay-Off of First Mortgage**	**New Loan Amount**	**Cash to LHA**
4303 19th St.	9/12/95	$411,671	$650,000	$233,570
4406-7 20th St.	7/11/95	276,898	550,000	269,562
TOTALS		$**688,569**	$**1,200,000**	$**503,132**

Office building income not reported

The LHA did not report to HUD the lease revenue and other income received from its new office building. From February 1995 through March 1997, the LHA collected $171,343 in lease payments and other revenues from the property. The LHA deposited these funds in a separate LHA bank account. Also, the LHA accounted for the revenues on books and records separate from the Low Rent Program. Thus, the LHA did not include revenue amounts in the data reported to HUD as other income for subsidy calculations. As stated in Finding 2, the LHA used grant funds for remodeling and maintaining the building. The LHA also used low rent funds for purchasing the building.

Low rent funds used to purchase office building

The LHA used $129,075 in low rent funds to pay for costs related to the purchase and upkeep of its new office building. The LHA used $35,420 to pay for selected items related to the purchase: $21,700 for the downpayment; $10,169 paid at closing; $1,500 for the application fee; and $2,051 for miscellaneous purchase costs. The LHA also used at least $93,655 for the remodeling and upkeep of the building. At

September 30, 1996, the LHA's general ledger showed a receivable due low rent for $65,514.57 of the costs.

According to Board minutes, the Board approved negotiations with RTC for the LHA to purchase the First Federal Bank Building in February 1993. In May 1993, the Executive Director explained to the Board the need for new LHA offices. He stated that the LHA did not have adequate space to park its vehicles. Also the City of Lubbock was willing to help the LHA obtain the First Federal Bank Building. The City could obtain an advance on its CDBG grants and make a loan to the LHA. The LHA could pay back the City over 20 years. The Executive Director preferred that the LHA not incur debt for longer than 5 years.

At the August 1994 Board meeting the Executive Director stated that HUD may waive the required $80,000 Turnkey III payment. He said if HUD approves the waiver then the LHA could use the funds toward purchase of the new office building. He said the LHA may use additional Turnkey III funds of $331,000 on the purchase. He said HUD will make the final decision regarding the use of these funds.

On October 7, 1994, the Executive Director told the Board HUD's decision regarding the proceeds from the Hub Homes property sale. HUD approved for the LHA to keep the net sale proceeds to use toward the purchase of the office building. He estimated the net proceeds to be about $191,000. He also stated that the LHA had submitted to HUD a request to retain the $261,149 sale proceeds from the Turnkey III homes. A Fort Worth HUD Office representative stated it probably would be approved. The Board then adopted a resolution authorizing the purchase of the First Federal Bank Building from RTC for $434,050. The LHA had already paid $21,700 from low rent funds for a purchase escrow. The Board also authorized the LHA to obtain a bank loan for the balance of the purchase. Board members expressed hope that the LHA would pay off the loan within a year with the funds in the pipeline. The following shows the property location, purchase date and price, and sources of funds for the purchase.

Property Location	**Settlement Date**	**Purchase Price**	**Loan Amount**	**Cash from LHA**

1601 Broadway	1/13/95	$434,050	$404,000	$31,869

Expenses and net income of non-low rent properties could not be ascertained

The CLHI managed the office building and the non-low rent apartment complexes. The CLHI's computer records for October 1995 through September 1996 were lost when its computer malfunctioned. Also, any expenses paid for the operation of the non-low rent properties may be questionable because the CLHI had no budget approved by the Board or HUD. The administrator stated that she planned to reconstruct the computer records from her source documents but it would take some time. Therefore, we could not ascertain the net income of the non-low rent properties to be used in adjusting the LHA's operating subsidy.

The LHA used two separate checking accounts to pay the operating costs of non-low rent properties, other than those costs charged to other programs as identified in Finding 2. The Executive Director or the CLHI Administrator usually decided what would be purchased or paid from CLHI revenue. One employee told us the CLHI was set up to allow the LHA to do things and incur costs that were not so strictly regulated by HUD. For example, the CLHI bought a vehicle for LHA's use because LHA could not get one approved by HUD in its budget. The CLHI did not have a budget that was approved by either the LHA Board or HUD. Also, there was no guidance for deciding appropriate cost for the properties. Without such guidance the calculation of net income to be used to adjust operating subsidy for the Low Rent Program is difficult and leaves to interpretation what should be included. A cost that is not allowable under the Low Rent Program may be acceptable under the CLHI.

According to LHA personnel, the LHA began processing the CLHI costs through the LHA's computer system for payment. The LHA codes the payments to identify the costs to the specific properties. In April 1997, the LHA began recording the property's revenues on its computer system. Since there was a lack of guidance to decide cost appropriateness and recordkeeping problems, we did not calculate the CLHI's net income.

Auditee Comments

LHA officials said they agree with the finding except for the affect on HUD's calculation of the operating subsidy. They said their original intent was to have two separate legal entities: the LHA and the City of Lubbock Housing Initiatives (CLHI). This was not done properly. Proper steps are being taken to transfer the property titles to CLHI and set up notes to repay the Low Rent Program. When this is accomplished, the net incomes will also be transferred to CLHI to accomplish the original goal. Since all income and property will be in CLHI, the LHA operating subsidy should not be affected. They agree that Low Rent Program funds were used to purchase non-low rent apartments and the office building. They stated they will use the amounts identified in the audit to set up the notes payable to the LHA when the property titles are transferred to CLHI.

OIG Evaluation of Auditee Comments

The LHA's original intent has no bearing on whether the LHA's operating subsidy for the period should be affected by the income received from the office building and the non-low rent apartments. The LHA and HUD agreed that the office building and the non-low rent apartments belong to the LHA's Low Rent Program because funds from the Low Rent and Grant Programs were used to purchase, rehabilitate, and maintain them. Thus, the income derived from these properties belonged to the Low Rent Program. Such income has a direct affect on the amount of subsidy the LHA receives to provide adequate housing to low income tenants.

The LHA's plan to transfer the properties' titles to the CLHI and set up notes to pay the Low Rent Program is sound except for the amounts the Low Rent Program would receive based on the questioned costs identified by our audit. The amount we identified in the audit may not be the total amount of low rent and grant funds spent by the LHA on the properties. We did not review every item paid for with program funds during the audit period. We did not look at every contractor payments. We could not quantify the LHA's force account labor spent on these properties because of a lack of specific and reliable LHA records. Therefore, for the LHA to transfer the properties to the CLHI at the understated cost amounts would deprive the Low Rent Program of its funds and low income tenants of potential improvements to their housing.

Based on the auditee's response, we have added a recommendation that addresses the transfer of properties to the CLHI. If the properties are transferred from the Low Rent Program to the CLHI, then it should be done at market value. The LHA should obtain appraisals for each property. These appraisal amounts should be the sales prices for the properties. The CLHI might obtain first lien mortgages from financial institutions for the property purchases. If the CLHI still lacks sufficient funds for the purchase, then the Low Rent Program and HUD might consider second lien notes for the balances.

Recommendations

We recommend HUD require the LHA to:

3A. Determine the net income for each fiscal year from the properties managed by CLHI;

3B. Report the net income amounts to HUD and repay HUD the excess operating subsidies that the LHA received; and

3C. We further recommend that HUD evaluate the validity of the LHA's net income determinations and ensure that the amounts of annual operating subsidy is properly adjusted; also

3D. If the LHA decides to transfer properties to the CLHI, ensure the transfers are done at current market value based on appropriate appraisals.

Project Sales Proceeds Misused

The LHA did not follow HUD's instructions regarding the use of $379,216 in sales proceeds, but instead used most of the money for other purposes. The proceeds consisted of $156,004 from the sale of LHA's Hub homes (owed to the Federal Financing Bank) and $223,212 in Turnkey III sales proceeds and residual receipts. HUD instructed the LHA to pay off what it owed on the Hub homes and permitted it to keep the Turnkey sales proceeds to purchase the new office building. However, the LHA apparently ignored the instructions. Since the LHA did not follow HUD's instructions on the use of the proceeds, it still owes these funds to the federal government.

Criteria

Part Two of the Consolidated Annual Contributions Contract (ACC) dated September 17, 1976, between the LHA and HUD provides terms and conditions of the contract. Sections 308(B) and 417(A) provides that proceeds from sales of real property must be deposited in the advance amortization fund to be used to reduce or retire any outstanding obligations.

Section 1 of Part A of the LHA's new ACC dated October 12, 1995, states that the new ACC in no way affects obligations outstanding, accounts due, or other actions taken pursuant to such previous ACCs.

Special provisions for Turnkey III Homeownership Opportunity Projects requires the LHA to operate the project in accordance with requirements for the program as prescribed by the government. The special provisions also require the amounts the LHA received for the conveyance of properties to be applied to any outstanding obligations on the properties. Further, during the maximum contribution period these provisions require the LHA to pay the government all residual receipts within 60 days after the end of each fiscal year. These payments are to be applied to the reduction of Annual Contributions by the government for the project.

On March 20, 1995, the LHA executed with HUD a Loan Forgiveness Amendment to the Annual Contribution Contract for the Turnkey III projects. Section f. states the deposit and use of the funds is subject to and conditioned upon the waiver of any regulatory provisions, the development and submission of a plan by the LHA and approved by HUD to use the funds, and a contractual agreement between the LHA and HUD governing the use of the funds.

Part B, Attachments III and VI, of the Consolidated Annual Contributions Contract dated October 12, 1995, contains the same requirements. The proceeds will be used to pay off the principal and interest due on project notes and to make the required Turnkey III payments to HUD.

On March 10, 1995, the LHA executed with HUD an Administrative Use Agreement for the Proceeds of Sales of Homeownership Projects. The agreement authorizes the LHA to retain the sale proceeds subject to and according to the provisions of the agreement. Section 3 of the agreement stipulates that: (1) the sale proceeds may be used only for lower income housing use approved by HUD; (2) the proceeds will be kept in appropriate reserve accounts until used; and (3) the LHA's Board of Commissioners is responsible for ensuring the proceeds are used according to the agreement. Section 10 of the Agreement states that any one of the following acts shall constitute a default by the Housing Authority: (1) The Housing Authority has used, or is using, proceeds of sale for purposes not permitted by, or inconsistent with, the provisions of this Agreement, provision or warranty made in this Agreement; (2) the Housing Authority has failed to comply with any other covenant, agreement, provision or warranty made in this Agreement; (3) an audit reveals evidence of mismanagement of funds; or (4) the Housing Authority has demonstrated an intention not to perform any or all of its obligations under this agreement.

Section 11 of the Agreement provides sanctions and remedies that HUD may take upon occurrence of a default. The sanctions and remedies include recapture for good cause any funds made available to the Housing Authority pursuant to the agreement and the Loan Forgiveness Amendment.

The LHA sent letters to HUD dated October 6, 1993; May 10, 1994; June 28, 1994; and September 1, 1994, requesting a waiver for its Turnkey III funds. The LHA requested the retention and refund of excess residual receipts, operating reserves, and proceeds for the sale of Turnkey III Homeownership units. The LHA stated it would use the funds for the purchase of an existing multi-purpose building that would include the LHA's offices.

On November 26, 1994, HUD's Assistant Secretary for Public and Indian Housing issued a memorandum to the Fort Worth Office of Public Housing approving a waiver for the LHA. The waiver allowed the LHA to retain the excess residual receipts, operating reserves, and proceeds it had obtained from the sale of the Turnkey III Homeownership units. The waiver provided that the LHA use the excess residual receipts for modernization purposes and the proceeds from the sale of homeownership units only for eligible low income housing purposes, all in accordance with the LHA's approved use plan. The LHA's approved plan was to use the funds on the purchase of the multi-purpose building. The waiver says:

> "Any deviation in the use of proceeds from the sale of homeownership units or excess residual receipts from the use specified in the approved plan will require an amendment to the ACC and/or Administrative Use Agreement, as appropriate."

LHA did not pay off the Federal Financing Bank obligation

The LHA did not pay off the $129,666 Hub Homes project note balance with the Federal Financing Bank when the LHA sold the final piece of property. The property sold for $300,000 in August 1995.

HUD approved the demolition and disposal of the Hub Homes property on September 1, 1993. The HUD approval had two conditions:

- The LHA must sell the property at a public sale when real estate market conditions improved and

- The LHA must pay off the outstanding debt on the Hub Homes with the net proceeds from the sale.

HUD's Office of Finance and Accounting sent a memorandum dated September 1, 1994, to the Fort Worth Office of Public Housing. The memorandum stated that as of November 1, 1993, the unpaid principal due to the Federal Financing Bank for the Hub Homes project notes was $134,781.05.

On March 16, 1994, the LHA requested HUD to allow it to retain the net sale proceeds to use in purchasing the multi-purpose building. The LHA would use the building for its offices.

On August 10, 1995, HUD executed a Partial Release of Declaration of Trust that permitted the LHA to sell the property to a private individual or entity. Also, on August 10, 1995, the LHA completed the property sale and received net sale proceeds of $297,574.

On August 22, 1995, the LHA's financial officer notified the deputy executive director that an unknown portion of the proceeds were due to HUD. The note also stated that the executive director would tell them the amount to pay HUD. Neither the Federal Financing Bank nor HUD approved a debt forgiveness for the note.

On August 21, 1995, the LHA put the sale proceeds into a 32-day Certificate of Deposit. On September 22, 1995, the LHA split the sale proceeds and interest into three 32-day Certificates of Deposit ($100,000; $100,000; and $98,716.68). The Certificates of Deposit were automatically renewable at maturity. On December 28, 1995, the LHA "temporarily" cashed one $100,000 Certificate ($101,156.43 with interest) to "cover payroll and other expenses." On April 25, 1997, the LHA had only one of the original certificates of deposit ($100,000). The remainder of the sales proceeds had been spent.

As of November 1, 1997, the LHA will owe HUD and the Federal Financing Bank $156,004. Since the property sale HUD has paid annual payments totaling $71,714 to the Federal Financing Bank on behalf of the LHA. Also, the principal balance on the Federal Financing Bank note at November 1, 1997, will be $84,290.45. This is based on information we obtained from HUD Headquarters.

The LHA did not use Turnkey III sales proceeds for office building

The LHA deceived HUD to retain $223,212 of Turnkey III proceeds. In October 1993, the LHA had not paid HUD the $223,212 for the Turnkey III sales proceeds and excess residual receipts from October 1, 1987, to September 30, 1993. On October 6, 1993, the LHA requested HUD to approve a waiver for the LHA to retain the Turnkey III funds. The LHA requested the waiver for retention of excess residual receipts, operating reserves, and proceeds for the sale of its units. The LHA stated that it would use the funds to purchase an existing multi-purpose building. The building would be used by the LHA's low income housing developments. Also it would house the Resident Council/Self-Sufficiency programs and other activities. The LHA in partnership with the residents, local government, and the LHA's management team established priorities to decide the building's use. On May 10, 1994, the LHA provided HUD clarification on its request regarding retention of the funds. The LHA stated the building was in downtown Lubbock and could be purchased from RTC for about $435,000. On June 28, 1994, the LHA submitted a letter to Fort Worth Office of Public Housing regarding the purchase of the building that included the following statements:

- The LHA owns the building.

- Some funds to purchase the building (downpayment) came from residual funds left from the highway funds. (The highway funds came from the sale of a portion of the property.) The balance needed for the purchase will be financed through RTC with a loan.

- The funds from the Turnkey III Program will not sufficiently cover the cost of the building purchase. The LHA hopes that HUD will allow us to retain the proceeds from the sale of the Hub Homes property. These proceeds when added to the retention of the Turnkey III sales would cover the purchase costs.

On September 1, 1994, the LHA submitted to HUD additional information regarding its request to retain the Turnkey III proceeds. The LHA said that all Turnkey III funds will be used to reduce the debt against the bank building recently purchased from RTC.

On September 9, 1994, Fort Worth HUD Office of Public Housing recommended approval of the waiver to HUD's Assistant Secretary of Public and Indian Housing. The recommendation was based on the LHA's request to retain the Turnkey III funds. Also it was based on the LHA's assurances and statements that the funds would be used to purchase a building for the LHA's offices. The Fort Worth Office of Public Housing assured the Assistant Secretary that the LHA would use all funds forgiven to reduce the debt on the purchased building. The forgiven funds also include residual receipts and operating reserves.

On November 26, 1994, HUD's Assistant Secretary for Public and Indian Housing approved the waiver. The waiver allowed the LHA to retain the excess residual receipts, operating reserves, and proceeds it obtained from the sale of the units. The funds retained would be used for the purchase of the building. On March 10, 1995, the LHA and HUD executed an Administrative Use Agreement for the Proceeds of Sales of Homeownership Projects. On March 14, 1995, HUD approved a Loan Forgiveness Amendment to the Annual Contribution Contract regarding the Turnkey III funds retained by the LHA.

On January 13, 1995, the LHA completed the purchase of the multi-purpose building from RTC. The final purchase price was $434,050. The LHA obtained a $404,000 loan from a local bank for the purchase costs not covered by the downpayment. The LHA is making monthly payments on the loan. As of April 1997, none of the Turnkey III funds HUD allowed the LHA to retain had been used to reduce the indebtedness. Thus, the LHA did not comply with HUD's waiver for the LHA to retain the funds. Since the LHA did not comply with the conditions of the waiver, the LHA owes HUD $223,212.

Auditee Comments

LHA officials agree that the purchase of the administration building was not handled in accordance with HUD instructions. They disagreed that the LHA has only $100,000 from the Hub Homes sale and that the remainder of the proceeds have been spent. As of August 29, 1997, they said they had $208,634.81 from the original sales proceeds. They said a $100,000 certificate is deposited at Canyon Lakes Credit Union and the remaining $108,634.81 is deposited in an operating reserve account at Norwest Bank.

OIG Evaluation of Auditee Comments

We were unable to verify the LHA's statement that the $108,634.81 deposited at Norwest Bank was part of the original Hub Homes sale proceeds. However, we accept the

LHA's statement as valid. Thus, the LHA has $208,634.81 readily available to pay on its Federal Financing Bank notes and the amount it owes to HUD.

Recommendations

We recommend that HUD require the LHA to pay HUD:

4A. The balance of $84,290.45 due on the project notes with the Federal Financing Bank as of November 1, 1997, and the $71,714 in note payments paid by HUD on behalf of the LHA since August 10, 1995, and

4B. The $223,212 in Turnkey III Homeownership program proceeds that was due HUD from the LHA.

Internal Controls

In planning and performing our audit, we considered internal controls of the management of the Authority to determine our auditing procedures and not to provide assurance on the internal control. Internal controls include the process by which an entity obtains reasonable assurance as to achievement of specified objectives. Internal control consists 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.

Significant Controls

We determined the following management control categories to be relevant to our audit objectives:

- Procurement and Contracting
- Accounting for grant draw downs, expenditures, and income
- Eligibility of low rent and grant expenditures
- Validity of other income and other data included in reports to HUD

We evaluated all of the relevant control categories identified above by determining the risk exposure and assessing the control design and implementation.

Significant Weaknesses

A significant weakness exists if internal control does not give reasonable assurance that the entity's goals and objectives are met; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Based on our review, we believe significant weaknesses exist in each of the areas as shown in Findings 1, 2, 3, and 4.

Follow Up on Prior Audits

On August 9, 1996 the LHA's Independent Auditor issued an Audit Report on the LHA's operations for the year ending September 30, 1995. The report contained numerous findings which as of July 2, 1997, were not reported by the LHA to HUD as being resolved. The following are some of the more significant findings reported by the Independent Auditor:

1. The LHA made questionable payments totaling $488,075 to eight vendors. The LHA used CGP and HOPE I funds to pay the vendors.

2. There was no documentation of the LHA's procurement policy. There were instances where large purchases over $10,000 were transacted without going through competitive bidding.

3. The LHA did not maintain documentation to support two journal entries totaling $18,938.09 which decreased the LHA's cash balance.

4. The LHA had no system to systematically allocate payroll costs. Some programs did not receive their fair share of payroll costs.

5. The LHA had not set up separate bank accounts for Homebuyers' (Turnkey III) maintenance and owner reserves. The Low Rent Program had used these funds.

6. There were instances where the prior Executive and Deputy Directors were paid over 100 percent of the budgeted salaries for their services. The excessive portion had no payroll taxes withheld.

7. The LHA's general ledger was not in balance. It was out of balance most of the year. Internal and external reports were wrong and misleading.

8. The LHA was operating an off-the-books cash account fund controlled by the former Executive Director. Income was unreported for the year.

9. The LHA allocated all administrative salaries and expenditures to programs and projects based on out-of-date allocation percentages. HUD may disallow some allocations to programs as unreasonable and unnecessary.

10. The LHA had not conducted a physical count of its fixed assets and prepared an inventory listing. Thus, the balances in the general ledger were unsupported and the LHA had no controls to safeguard its assets.

11. The LHA did not properly segregate the duties of the CGP Administrator regarding hiring, work schedules, purchasing and contracting, receiving goods, invoice acceptance and coding, and distribution of vendors' checks.

12. The LHA sold the Hub Homes property without securing a current appraisal. There was no public notice of the sale and no sealed bids were sought.

On July 14, 1995, the LHA's Independent Auditor issued an Audit Report on the LHA's operations for the year ending September 30, 1994. Four of the 12 findings we listed from the 1995 Audit Report (Numbers 7, 8, 9, and 10) were repeat findings from the 1994 Report.

Schedule of Questioned Costs

Recommendation Number	Ineligible[3]	Unsupported[4]
1B	$ 320,286	
1C		$ 97,634
2B	115,018	
2C	195,604	
2D		410,232
4A	156,004	
4B	223,212	
TOTALS	$1,010,124	$507,866

1 Costs clearly not allowed by law, contract, HUD, or local agency policies or regulations.

2 Costs not clearly eligible or ineligible but which warrant being contested (e.g., lack of satisifactory documentation to support the eligibility of the cost, etc.)

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