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Audit Report Number
2008-LA-1009

TO: Paula O. Blunt, General Deputy Assistant Secretary for Public and Indian Housing, P

K.J. Brockington, Director, Los Angeles Office of Public Housing, 9DPH

Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Housing Authority of the City of Eloy, Arizona Did Not Have Adequate Internal Controls to Safeguard Assets and Ensure Compliance with HUD's Requirements

HIGHLIGHTS

What We Surveyed and Why

We audited the Housing Authority of the City of Eloy (Authority) because the U.S. Department of Housing and Urban Development's (HUD) Office of Public Housing had rated the Authority as troubled since 2002. The Authority had significant problems with financial management and terminated the executive director.

Our audit objectives were to (1) determine why the Authority had been rated troubled for the past five years and (2) assess the Authority's internal controls over its public housing and Section 8 programs and identify areas at risk for noncompliance, waste, fraud, or abuse.

What We Found

The Authority was rated troubled because it had failed to submit its independent audit report to HUD within the required timeframe since 2002 and did not have adequate internal controls to reasonably ensure that HUD funds were used in accordance with program requirements or that its practices complied with HUD's and other federal requirements.

Because the Authority did not fully implement corrective actions required by HUD, it was not in compliance with HUD rules and regulations with respect to its annual contributions contracts with HUD, the Section 8 and public housing regulations, and Office of Management and Budget circulars. As a result, more than \$2 million in federal funds was placed at risk, and the Authority incurred unnecessary expenses and struggled to meet its operating expenses.

What We Recommend

We recommend that the Director of HUD's Los Angeles Office of Public Housing require the Authority to immediately develop and implement effective policies and procedures that include sound internal controls for its operations in all areas and to immediately direct the Authority to negotiate with the Internal Revenue Service (IRS) to abate \$81,537 in interest and penalties on employee withholding taxes owed. We further recommend that HUD closely monitor the Authority and its board of commissioners until management weaknesses have been resolved.

In addition, we recommend that the General Deputy Assistant Secretary for Public and Indian Housing issue a proposed notice of the Authority's default of its public housing contracts, and take appropriate actions that will result in better use of \$168,263 in public housing funds. We also recommend that the General Deputy Assistant Secretary issue a proposed notice of the Authority's default of its Section 8 contract, and take appropriate actions that will result in better use of \$587,102 in Section 8 funds.

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

Auditee's Response

We provided our discussion draft report to the Authority on April 9, 2008, and held an exit conference on April 21, 2008. The Authority neither agreed nor disagreed with our report findings.

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

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BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Eloy (Authority) is a small housing authority, incorporated about 1952. It operates 50 public housing units, services 159 vouchers, and employs a staff of four. The Authority's authorized budgets for HUD programs in fiscal years¹ 2006 and 2007 were \$1,030,595 and \$1,015,481, respectively.

HUD Program	FY 2006	FY 2007	Totals
Public Housing Operating Fund	\$124,449	\$129,254	\$253,703
Public Housing Capital Fund	\$89,610	\$91,726	\$181,336
Housing Choice Vouchers (Section 8)	\$816,536	\$794,501	\$1,611,037
Totals	\$1,030,595	\$1,015,481	\$2,046,076

The Authority's board of commissioners consists of six members including one nonvoting member who acts as a liaison between the City and the board. The Authority has a history of funds misuse by management, and U.S. Department of Housing and Urban Development (HUD) officials have identified apparent irregularities. Since June 2007, when the Authority faced a cash shortfall, HUD has required the Authority to obtain HUD approval before all expenditures (except for items involving emergency repairs that may affect the health and safety of the residents).

Under the public housing program, HUD administers federal aid to local housing agencies that provide affordable housing for low-income residents. HUD furnishes technical and professional assistance for planning, developing, and managing these developments. The housing agency is responsible for establishing each participant's eligibility and for the management and operation of its public housing units.

HUD measures the performance of each public housing program through its Public Housing Assessment System. HUD annually² scores the housing agency in four operational areas—physical, financial, management, and resident satisfaction. Low scores result in a status rating of troubled, which triggers certain corrective actions by HUD. Initially, HUD issues a memorandum of agreement that includes performance targets, strategies in achieving performance targets, and technical assistance from HUD. If a housing agency fails to improve, HUD can exercise interventions and, if warranted, declare that the agency is in default with regard to its contract with HUD and terminate the contract. In 2002, the Authority was designated troubled due to its zero score under the financial component. It continued to be troubled through the most recent rating period for the same reason.

¹ The Authority's program year extends from July 1 through June 30.

² Small housing authorities, with fewer than 249 units, may be rated every other year if they are not designated troubled.

HUD's Section 8 program assists very low-income families, the elderly, and the disabled in obtaining decent, safe, and sanitary housing in the private market. Eligible participants are issued housing vouchers and are responsible for finding suitable housing of their choice where the owner agrees to rent under the program. The housing agency pays a subsidy directly to the owner on behalf of the participant. The participant pays any difference between the subsidy and the rent charged by the owner. HUD provides the housing agencies with funding for the housing subsidies and related administrative expenses. The agencies are also responsible for establishing the eligibility of the participants and approving the selected housing units.

HUD annually assesses the performance of each housing agency's Section 8 program based on indicators measured under the Section Eight Management Assessment Program (Section 8 Assessment). As with the Public Housing Assessment System, low scores under the Section 8 Assessment can result in a status of troubled and trigger corrective actions by HUD. HUD may require the housing agency to submit a corrective action plan if deficiencies are not corrected within 45 days after HUD's notification to the agency. In the case of the Authority, HUD did not require it to submit a corrective action plan when it was rated troubled for Section 8 in 2006 because, according to HUD officials, the public housing memorandum of agreement addressed overarching management problems that needed to be resolved first.

Our audit objectives were to (1) determine why the Authority had been rated troubled for the past five years and (2) assess the Authority's internal controls over its public housing and Section 8 programs and identify areas at risk for noncompliance, waste, fraud, or abuse.

RESULTS OF AUDIT

Finding 1: The Authority Did Not Have Adequate Internal Controls to Safeguard Assets and Ensure Compliance with Public Housing and Section 8 Program Requirements

The Authority did not create and implement adequate internal controls to reasonably ensure that HUD funds were used and safeguarded in accordance with program requirements and its annual contribution contract agreements with HUD. For example, there were no financial controls over disbursements, and inadequate program policies and procedures allowed violations of public housing and Section 8 regulations to occur. Internal controls were inadequate because the Authority's board of commissioners did not perform its fiduciary responsibility to provide effective oversight. As a result, more than \$2 million in federal funds was placed at risk, and the Authority incurred unnecessary costs and struggled to pay its operating expenses.

Financial Management Was Weak

We identified significant financial management control weaknesses in the following areas: financial recordkeeping and reporting, budgeting, procurement, and safeguarding cash resources. United States Office of Management and Budget guidance for audits of federal grantees states that the auditee shall maintain internal controls over federal programs that provide reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on each of its federal programs (see appendix C, criterion number 1).

The Authority had not had a financial manager for several years. At the time of our review, the Authority used a fee accountant for all of its financial management activities; however, the engagement letter did not require the accountant to perform significant control functions. The fee accountant processed payroll, paid bills, recorded accounting transactions, reconciled bank statements, and generated accounting/financial reports. The accountant did not identify and/or address significant deficiencies or material weaknesses in the Authority's internal controls. For example, the accountant did not verify or check the accuracy of transaction information provided by management, including information used to adjust account balances.

The Authority previously neglected its tax obligations to meet its operating budgets. The former financial officer deferred payment of employee withholding taxes from September 2000 through December 2003 by failing to mail them although they were prepared and signed. As a result, the Authority owed the Internal Revenue Service (IRS) at least \$199,907 as of its October 18, 2006 statement. In November 2006, the IRS approved a

repayment plan with monthly installments of \$6,000, and filed a tax lien against the Authority's property. As of July 2007, the balance owed was \$163,784 (including \$51,447 in interest and \$30,089 in penalties).

The Authority was unable to provide us with its procurement policy and procedures and had inadequate controls over purchases. For example, there were no purchase orders and no procedures to verify delivery of goods and/or services before vendors were paid. HUD's Procurement Handbook states that housing agencies must establish appropriate internal controls to ensure the proper expenditure of funds.

The rent receipts procedure was at risk for misappropriation of cash and application of rent to the wrong unit. Specifically, the procedures for rent deposits had no separation of duties. No individual monitored the rent accounts receivables or reconciled the rent receipts with a rent schedule. According to the independent auditor, the Authority did not adequately track tenant security deposits.

Financial Audits and Reviews Had Reported Problems since 2004

In March 2004, HUD conducted a financial review and determined that the Authority did not maintain records and was not financially sound because there was no oversight of the Authority's financial operations. The review also found that the Authority's board relied on the former executive director to manage the Authority. In turn, the former executive director relied on accounting staff that did not perform their duties.³

The independent audit for 2006 found that the Authority's adjusting journal entries lacked adequate backup and evidence of supervisory review and management approval. In both 2005 and 2006, the independent auditor reported that the Authority did not have a current listing of security deposits, by tenant.

The independent audit report for 2007 was not issued at the time of our review; however, the auditor stated that potential findings include unsupported journal entries and poor recordkeeping.

Personnel Policies Were Inadequate to Prevent Abuse

The Authority did not ensure that its organization and staffing served the best interests of its low-income public housing and Section 8 programs. Section 4 of the annual contributions contract with HUD states that the Authority shall, at all times, develop and operate each project solely for the purpose of providing decent, safe, and sanitary housing

³ The 2004 financial review was conducted by a different HUD field office and resulted in a memorandum of agreement that prescribed corrective actions. HUD later transferred oversight of the Authority to the Phoenix HUD field office, but officials were unable to provide the Office of Inspector General (OIG) with records to document the Authority's compliance/noncompliance with the 2004 agreement.

for eligible families in a manner that promotes serviceability, economy, efficiency, and stability of the projects and the economic and social well-being of the tenants (see appendix C, criterion number 2). Abuse of the Authority's leave-sharing program occurred because the leave policies lacked adequate controls and specificity. Records showed that the former executive director received a significant number of donated sick leave hours which were then cashed instead of being used for medical reasons. The independent audit for 2006 also reported excessive compensation for sick and vacation leave.

Other deficiencies in personnel policies and practices included the following:

- The personnel policy did not contain procedures for qualifying or hiring employees. Our review of the personnel files determined that employees were not evaluated on a regular basis. Further, the personnel policy required probationary performance evaluations, which we did not find in the files.
- The Authority violated HUD's conflict-of-interest requirements by employing an immediate relative of a member of the board without obtaining a waiver. The personnel policy contained a provision for hiring individuals that were relatives of the Authority's employees, but it did not specifically address hiring individuals related to members of the board of commissioners. Section 19 of the public housing annual contributions contract stated that the Authority was not allowed to hire an employee in connection with a project if the prospective employee was an immediate family member of any person belonging to any present or former member or officer of the governing body of the Authority. This requirement could be waived by the board, provided that such waiver was permitted by state and local law (see appendix C, criterion number 3). We found no waiver during our review.
- The Authority's job descriptions for its employees were inadequate. For example, the job descriptions did not clearly describe responsibilities or performance standards. The Authority was unable to provide us with the executive director's position description as well as some of the employee personnel records.

Public Housing Program Controls Were Weak

The Authority's controls over its public housing program did not ensure compliance with HUD's requirements for property maintenance, health and safety, or resident admissions standards. The public housing policies and procedures were inadequate and failed to include HUD requirements for exigent health and safety (emergency) conditions and the uniform physical condition standards. HUD requires housing agencies to adopt admission policies which meet all applicable laws and regulations, and to post copies of

the admission policies in each office where applications are received (see appendix C, criterion number 4).

During our review, we noted the following deficiencies regarding the condition and maintenance of public housing units:

- Maintenance work order data entered into the Authority's automated system were unreliable. Also, work orders were not prioritized to ensure that the emergency work orders were completed within 24 hours as required, and the Authority did not follow its own policy regarding preventative maintenance.
- The Authority's procedure for tenant emergency calls after business hours placed public housing tenants and property at risk. Specifically, the tenant was to call the police station, which then called the executive director's phone number. This procedure became ineffective upon the executive director's departure in July 2007 because the Authority did not update the contact number/individual.
- The overall condition of the public housing units we observed was not decent, safe, and sanitary. We visited 10 units and noted that nine were not decent, six were not safe, and two were not sanitary. Some of the safety issues included a broken kitchen window, obstructed bedroom windows, and a broken back doorknob. In one unit, we observed continuously running water in the bathroom. The tenant stated that he had reported the situation to the Authority two weeks earlier. The maintenance person from the Authority was with us at that time and did not dispute the tenant's account.

We questioned whether the applications for public housing were properly processed because the housing specialist was not aware of the Authority's written admission policies until July 2007, despite having been in the job for four years. The housing specialist stated that she needed training and expressed concerns about the Authority's noncompliance.

Finally, the Authority was designated troubled under HUD's Public Housing Assessment System from 2002 through 2007 because it scored zero under the financial section for failing to submit its independent public accountant audit reports. In 2006 and 2007, the Authority's Public Housing Capital Fund program was also designated troubled. According to HUD public housing officials, the Authority routinely used its capital grant funds to cover operating expenses—a practice HUD allows for small agencies. In 2007, the Authority's public housing score was zero in two rating areas, financial and management.

Problems Persisted Despite Corrective Actions

HUD's Office of Public Housing field staff addressed the Authority's troubled status and other management deficiencies by conducting a financial review and providing on-site technical assistance. As a result, HUD and the Authority signed a memorandum of agreement on July 28, 2006, that contained the following corrective actions:

- (1) Provide ongoing training to current and future commissioners;
- (2) Design board reports to include more factual information on activities of the Authority;
- 3) Improve financial status by developing a plan using available capital funds that balances capital needs with an obligation to eliminate the amount due to the IRS as quickly as possible, and by producing and monitoring year-to-date budget variance reports for the low-rent program on a monthly basis beginning with the period ending June 30, 2006;
- 4) Reduce outstanding tenant receivables;
- 5) Reduce the occupancy loss; and
- 6) Submit the Authority's audited and unaudited financial statements to HUD electronically.

According to HUD officials, the Authority failed to complete all corrective actions within the timeframes required in the July 28, 2006, agreement. Our review of HUD field office records determined that the Authority did not comply with required monthly reports/actions for five of the six months from January through June 2007. Further, many of the corrective actions addressed the same issues raised in a 2004 memorandum of agreement executed between the Authority and the San Francisco HUD office. In particular, the 2004 agreement called for training of the board of commissioners and improved financial reporting.

In May 2007, HUD field office officials met with the mayor of the City of Eloy and presented possible HUD actions that included remedies for substantial default of the annual contributions contract. Paragraph 8 of the agreement stated that, if HUD determined that the housing agency had failed to meet the terms of or to make reasonable progress to execute or meet requirements in the agreement, the agency would be in substantial default with the agreement. Paragraph 10 further stated: "Notwithstanding anything to the contrary, upon occurrence of events or conditions that constitute a substantial default by the [housing agency] with respect to its obligations under the Annual Contributions Contract and applicable regulations to which the housing agency is subject *or this MOA*," HUD may petition for the appointment of a receiver (which may be another public housing agency or a private management corporation) or take other actions available.

Section 8 Program Controls Were Weak

Many of the management problems discussed in this report also impacted the Authority's administration of its Section 8 program. To assess control risk, we conducted a limited review regarding compliance with Section 8 program requirements. Observations of Section 8 units and reviews of tenant voucher files identified deficiencies regarding rent reasonableness, verification of eligibility, and applicant processing procedures.

The rent for one of two Section 8 units that we observed was not reasonable. We performed external inspections of the Section 8 units as well as the comparable units used by the Authority to establish rent reasonableness. We observed the units' outside structures, surroundings, and neighborhood and identified significant differences in condition and size. Specifically, the Section 8 unit, a three bedroom which rented for \$830, was in an old subdivision and appeared small and dilapidated. In contrast, the two comparables were in better subdivisions and appeared significantly newer or larger, despite rents of \$839 and \$939.

File reviews determined that the Authority did not have adequate procedures to ensure that the Section 8 landlords/owners were eligible to participate in the program. Two of the five owners' files that we reviewed did not have follow-up documentation regarding proof of ownership. HUD's guidance requires proper approval/disapproval by the housing authority and generally prohibits owners who are related to the assisted family. Additionally, one of five Section 8 tenant files reviewed did not contain documentation of the required criminal background check.

The housing specialist who processed Section 8 voucher applications (the same individual who processed applications for public housing discussed above) had inadequate training and guidance. She was not familiar with the Authority's Section 8 administrative plan until July 2007. The administrative plan states that the Authority must establish local policies for program administration and that the Authority is responsible for ensuring that the staff operates according to the policies spelled out in the plan (see appendix C, criterion number 5). The Authority did not have any other Section 8 program policies and procedures.

The Authority's independent audit for 2005 reported the following findings pertaining to Section 8:

- HUD Form 52681 (Voucher for Payment of Annual Contribution and Operating Statement for Section 8 HCV [Housing Choice Voucher] Program) was not submitted for fiscal year 2005. The report noted that this failure would result in reduced HUD funding for the program.
- Two utility allowance errors were noted in the Section 8 tenant files.
- Three of twenty files tested contained citizenship documentation errors.

HUD designated the Authority's status under the Section Eight Assessment as troubled in 2006 and 2007.⁴ HUD determined that, for both years, the Authority received failing scores for indicators regarding expanding housing opportunities, annual housing quality standards inspections, and lease-up. After the 2007 troubled rating the HUD Phoenix Office of Public Housing requested the Authority to develop a corrective action plan.

The Board's Oversight of the Authority Was Ineffective

The Authority's board of commissioners failed to provide effective oversight of the Authority. The board allowed the former executive director to have full control over the operations of the Authority and failed to ensure that internal controls were in place.

HUD OIG's Program Integrity Bulletin states that the commissioners have ultimate responsibility for housing agency operations including establishing policies such as personnel and procurement, reviewing and monitoring budgets and other financial documents to ensure that expenditures comply with federal and local laws, and ensuring that the housing agency is acting legally and with integrity. The bulletin also states that commissioners should ensure the establishment of sound management controls to protect against fraud and abuse. Further, the bulletin states that quality control systems should monitor petty cash disbursements and resident rent and accounts. To function properly, the bulletin states that the commissioners must have knowledge of the financial status and quality of the housing agency's operations and an understanding of the program requirements (see appendix C, criterion number 6). Our review of the Authority's board of commissioners' records and actions determined that it did not fulfill these responsibilities. For example,

- The board did not have bylaws or policies and procedures to direct its members and to oversee the Authority. The board members were uncertain of their authority over the executive director and their responsibilities to the Authority.
- The board did not participate in adopting or reviewing the Authority's policies and procedures and did not review the Authority's financial reports on a regular basis.
- The board minutes and agenda showed that the Authority's problems were discussed; however, in general, there were no resolutions or rulings from the board that corresponded to the problems. It appeared that the board did not pay serious attention to problems or other indications of the Authority's failing performance.

⁴ The Authority's Section 8 Assessment scores were 59 percent for 2006 and 55 percent for 2007. HUD designates any Section 8 program that receives a score of less than 60 percent as being troubled.

- In response to our questions regarding the lack of board action to ensure the Authority's interests, members stated that the board relied on the executive director to present important issues during board meetings.
- The board signed checks presented by the former executive director without requesting or examining supporting documents.
- The five voting board members had spent enough time in their positions to know their responsibilities and/or to obtain training available for commissioners. The chairperson joined the board more than 20 years ago, and all but one of the others had been on the board five to eight years before this review. The newest member joined more than a year ago. Two board members took training for commissioners in 2002, but members stated that funds were not available to send everyone. Nevertheless, a Nan McKay⁵ board of commissioner's guide for public housing agencies was provided to the members around April 2006. The guide explained the board's responsibilities and provided references for public housing and Section 8 programs. It also stated that the board members were responsible for their own performance and professional development. According to officials from the HUD field office, the Authority also purchased Nan McKay training modules, but officials thought that the training material had not been used.

Efforts to Correct Problems Were Slow

Although the Authority and HUD had been working to correct the reported problems, most of the conditions described above remained at the time of this report. During our discussions with board members regarding the draft finding, the members noted that since the former executive director departed in July 2007, the Authority had made an effort to improve its management controls. One board member volunteered as the acting executive director⁶ until the Authority hired a new one in November 2007. However, the substantial effort required to run the daily operations and correct problems left by the former executive director impeded progress in developing/revising and implementing needed policies and procedures. Further, the Authority continued to need financial expertise.

The Board's Inaction Damaged the Authority's Financial Position

As a result of the board's failure to ensure effective management and financial controls, including the implementation of policies and procedures over finances, personnel, and program compliance, over \$2 million in HUD funds were at risk for waste, fraud and

⁵ Nan McKay provides public housing training and consulting services.

⁶ HUD approved the action, and the member did not vote during the time.

abuse during the program years 2006 and 2007. The Authority continued to experience serious financial difficulties, and there were allegations of program violations and/or misappropriation of funds. A conflict of interest was allowed and individual staff members were given significant responsibility with minimal training and oversight.

The Authority incurred unnecessary expenses because the board failed to ensure the former executive director responded to IRS notices regarding the unpaid employment taxes owed. Board minutes disclosed that the commissioners were aware of the IRS debt as early as March 2003; however, an IRS letter dated October 2006 referred to an earlier notice to enforce collection and stated that the debt remained unpaid. Meanwhile, interest and penalties on the unpaid employment taxes continued to accrue. As of December 31, 2003, the amount of IRS interest and penalties accrued was \$65,548. Although the Authority began installment payments in December 2006, by July 2007 the accrued interest and penalties totaled \$81,537. Moreover, according to HUD officials the Authority’s monthly installment of \$6,000 to the IRS made it extremely difficult for the Authority to meet its operating expenses. The Authority remained viable only by using the HUD capital grant funds for its daily operations. Consequently, maintenance on public housing was deferred, and insufficient funds were available to hire qualified financial staff.

If the Authority continues to operate without financial and management controls and under the IRS debt burden (and the associated property lien), then current HUD funds totaling \$755,365⁷ will be at risk for waste, fraud, and abuse.

HUD Program	Authorized 2008 Amount
Public Housing Operating Fund	\$ 76,537
Public Housing Capital Fund	\$91,726 (a)
Housing Choice Vouchers (Section 8)	\$587,102
Total	\$775,365

(a) 2007 amount used because the 2008 capital grant authorized amount is not available

Recommendations

We recommend that the Director of HUD’s Los Angeles Office of Public Housing

- 1A. Require the Authority to immediately develop and implement effective policies and procedures that include internal controls for its operations in all areas.

⁷ The Authority’s fiscal year is July 1st to June 30th. It is currently operating under fiscal year 2008; therefore we used the 2008 HUD authorized grant amounts (when available).

- 1B. Immediately direct the Authority to negotiate with the IRS to abate interest and penalties on employee withholding taxes owed, thereby eliminating unnecessary costs of \$81,537 (funds to be put to better use), and to reduce monthly installment payments.
- 1C. Conduct on-site monitoring of the Authority's operations until HUD determines that
- The Authority is operating with adequate management and financial controls,
 - The members of the board of commissioners are fully performing their fiduciary responsibilities, and
 - The Authority's financial condition is sound.

We also recommend that the General Deputy Assistant Secretary for HUD's Office of Public and Indian Housing

- 1D. Issue a proposed notice of the Authority's substantial default of its annual contributions contracts for public housing and impose appropriate remedies in accordance with section 17 of the annual contributions contract to ensure better use of \$76,537 in public housing operating funds authorized for 2008 and \$91,726 in capital grant funds authorized for 2007.
- IE. Issue a proposed notice of the Authority's default in accordance with section 15 of the annual contributions contract for the rental certificate and rental voucher programs and take appropriate administrative sanctions to ensure better use of the \$587,102 in section 8 funds authorized for 2008.

SCOPE AND METHODOLOGY

Our audit generally covered the period July 1, 2005, through June 30, 2007, although we expanded the period as necessary to include significant events. To accomplish our objectives, we

- Reviewed relevant HUD regulations and guidance, Office of Management and Budget circulars, and other applicable laws and references.
- Reviewed the Authority's policies and procedures for financial management, procurement, and personnel.
- Reviewed the Authority's Section 8 policies and procedures, rent reasonableness, landlord eligibility, and tenant admission and occupancy. We also observed selected Section 8 units.
- Reviewed the Authority's public housing policies and procedures, work orders, unit inspections, and tenant admission and occupancy. We visited selected units to observe conditions and interview residents.
- Interviewed the HUD field office staff, one former and all current Authority staff members, several members on the Authority's board of commissioners, and former and current fee accountants.
- Reviewed files for tenants, landlords, and employees; board minutes; work orders; and payroll records.
- Reviewed the auditee's employee tax arrears.
- Obtained program funding and monitoring information from the HUD Phoenix Office of Public Housing.
- Contacted the third party training consultant to verify commissioner training.

Because our objective was to assess the existence and implementation of internal controls, we limited our testing and observations to the number of files, records, and properties necessary to make a reasonable assessment.

We performed our field work from September 4 through December 7, 2007, at the Authority's offices at 100 West Phoenix Avenue in Eloy, Arizona. We performed our review in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- Policies and procedures to ensure that the management and use of resources provided by HUD are consistent with laws and regulations.
- Implementation of policies and procedures to ensure that resources and/or assets are safeguarded against waste, loss, and misuse.
- Policies and procedures for Section 8 and public housing programs to ensure that the Authority's operations comply with HUD's regulations, the annual contributions contract, and other applicable laws.

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- The Authority did not have adequate internal controls to reasonably ensure compliance with Section 8 and Public Housing programs requirements.

APPENDIXES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use <u>1/</u>
1B	\$81,537
1D	\$86,726
1E	<u>\$587,102</u>
Total	\$755,365

1/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings which are specifically identified. The \$81,537 in IRS interest and penalties was based on the July 2007 balance provided by HUD officials. For 2008, HUD authorized \$76,537 for low-rent and \$587,102 for Section 8 programs. The 2008 capital fund grant figure was not available at the time of our report, therefore we used the 2007 grant amount of \$91,726. To avoid double counting, we deducted \$81,537 recorded under recommendation 1B for IRS penalties and interest from \$168,263 in total funding authorized for public housing programs, and computed \$86,726 for funds put to better use.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

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April 25, 2008

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Subject: Comment on Discussion Draft audit Report
Housing Authority of the City of Eloy

Dear Ms. Hobbs,

The Board of Commissioners of the Housing Authority City of Eloy acknowledges the concerns of Office of the Inspector General. We have reviewed your findings as well as your recommendations and are providing you with this our formal written comments. We the Board of Commissioners neither agree nor disagree with your findings, but have taken them under advisement and made changes within the organizational structure of the Housing Authority to become compliant within the guidelines.

The result of the audit was a finding against the Housing Authority of the City of Eloy:

Finding: The Authority did not have adequate internal controls to safeguard assets and ensure compliance with Section 8 and Public Housing Program requirements.

Comment: While the concerns addressed in this Audit cover a five year period from 2002 through 2007 we the Board of Commissioners recognize the urgency to correct the findings as promptly as possible. We have already begun the process to overcome the impediments that has given cause to the Housing Authority's continued troubled status. In November 2007 we hired a new Executive Director as a basis to establish a new foundation for the Housing Authority. Under new leadership the Housing Authority has started to implement policy and procedures to strengthen some of their weak areas to come into compliance with Section 8 and Public Housing Program requirements. This process when complete should ensure that federal funds are not placed at risk and the Authority is moving in the direction of financial stability.

As a result of the finding you made the following recommendations to the Director of HUD's Los Angeles Office of Public Housing:

Comment 1

Comment 2

Comment 3

- 1A. Require the Authority to immediately develop and implement effective policies and procedures that include internal controls for its operations in all areas.

Plan: The Board of Commissioners approved new revision of the Administrative Plan and Admission for Continued Occupancy Plans. The Executive Director has met with the staff to ensure they understand the purpose of the plans and how to use them to seek answers. The staff are required to utilize these documents as a daily guidance and reference tool for operations to ensure they are operating under the policies written in the plan that comply with the 24 Code of Federal Regulations parts 912, 913, 942 and 960. Personnel Policy and Procedures are being revised which will address the deficiencies considered as inadequate in the report and also provide internal control for operations in this area. The Housing Authority will incorporate the *Five Standards for Internal Control (Control Environment, Risk Assessment, control Activities, Information and Communications and Monitoring)* as written in the *Standard for Internal Control in the Federal Government (11/99)* which will provide a basic structure as policies are implemented.

- 1B. Immediately direct the Authority to negotiate with the IRS to abate interest and penalties on employee withholding taxes owed, thereby eliminating unnecessary cost of \$81,537 (funds to be put to better use), and to reduce monthly installment payments.

Plan: The Board has directed the Executive Director to make this a top priority issue as a result a meeting has been scheduled with the IRS in the near future to address the situation and to see what options are available to the Housing Authority.

Comment 4

Comment 5

The Housing Authority has already addressed some of the concerns mentioned in this report as part of the restructure of the organization. We continue to monitor maintenance work orders to ensure Public Housing units are maintained in decent, safe and sanitary conditions. Securing staff training is a priority to increase their knowledge of HUD Rules and Regulations and how to properly process paperwork. To make sure of timely submission of all HUD required reports. We will continue to seek advice and work closely with HUD representatives in the Phoenix Field Office to ensure the Housing Authority is operating with adequate management and financial controls, and that we the Board are performing our responsibilities to be confident the Housing Authority becomes financially sound.

We the Board of Commissioners of the Housing Authority City of Eloy believe we are progressing in the right direction to become a Standard Performing Agency.

Respectfully,



Novice Price
Chairperson Board of Commissioners
Housing Authority of the City of Eloy

cc: Margaret Skiffer Phoenix Field Office

OIG Evaluation of Auditee Comments

- Comment 1** The Authority stated they neither agree nor disagree with the findings. However, we note that they have taken the findings under advisement and made changes within the organizational structure.
- Comment 2** Our report recognizes that the Authority has recently taken steps, including the hiring of a new executive director, to correct its problems. We also note that the Authority's problems cannot be completely resolved by the new executive director, and that the Authority continues to need financial expertise. We support the effort to implement new policies and procedures and strengthen controls. The Board of Commissioners must approve the policies and procedures and ensure that they include adequate internal controls. During the audit resolution phase, the Authority must provide the HUD program office with its finalized policies and procedures for all areas of its operations.
- Comment 3** See response to comment 2
- Comment 4** As soon as the meeting with the IRS has taken place, the Authority must provide HUD with the results.
- Comment 5** We support the Authority's efforts to correct deficiencies cited in the report. We agree that Authority officials should continue to seek advice from the HUD Phoenix Office of Public Housing, and note that other resources are available such as: professional organizations for public housing officials, the HUD website, and officials from nearby housing authorities that are functioning at a standard level of performance.

The Authority did not comment on recommendations 1C, 1D and 1E.

Appendix C

CRITERIA

1. Office of Management and Budget Circular A-133, subpart C300(b), states that the auditee shall maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and provisions of contracts or grant agreements that could have a material effect on each of its federal programs.
2. Section 4 of the annual contributions contract states that the Authority shall at all times develop and operate each project solely for the purpose of providing decent, safe, and sanitary housing for eligible families in a manner that promotes serviceability, economy, efficiency, and stability of the projects and the economic and social well-being of the tenants.
3. Section 19 of the public housing annual contributions contract states that the Authority may not hire an employee if the prospective employee is an immediate family member of any person belonging to any present or former member or officer of the governing body of the Authority. This requirement may be waived by the board, provided that such waiver is permitted by state and local law.
4. HUD Directive 7465.1, REV-2 (Public Housing Occupancy Handbook), paragraph 1(a)(1), states that public housing authorities must adopt admission policies which comply with HUD regulations at 24 CFR (*Code of Federal Regulations*) Parts 912, 913, 942, and 960; Title VI of the Civil Rights Act of 1964; 24 CFR Part 1; all other civil rights requirements (paragraph 1-3(c)); the annual contributions contract; and state and local laws. Paragraph 1(a)(6) also states that the public housing authority must post copies of the admission policies in each office where applications are received.
5. Housing Choice Voucher Program Administrative Plan, section 3.1, states that the public housing authority must adopt a written administrative plan that establishes local policies for program administration. It also states that the public housing authority is responsible for insuring that the staff operates under the policies spelled out in the plan.
6. HUD OIG's Program Integrity Bulletin states that the commissioners have ultimate responsibility for public housing authority operations including establishing policies such as personnel and procurement, reviewing and monitoring budgets and other financial documents to ensure that expenditures are in compliance with federal and local laws, and ensuring that the public housing authority is acting legally and with integrity. The bulletin also states that commissioners should ensure the establishment of sound management controls to protect against fraud and abuse. Further, the bulletin states that quality control systems should monitor petty cash disbursements and resident rent and accounts. To function properly, the bulletin states that the commissioners must have knowledge of the financial status and quality of public housing authority operations and an understanding of the program requirements.

7. Regulations at 24 CFR 985.109 state that HUD may determine that a public housing authority's failure to correct identified Section 8 Assessment deficiencies or to prepare and implement a corrective action plan required by HUD constitutes a default under the annual contributions contract.
8. Regulations at 24 CFR 85.20(3) state that effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must ensure that it is used solely for authorized purposes.
9. Housing Act of 1937, section 2(a)(1)(C), states that it is the policy of the United States to promote the general welfare of the nation by employing the funds, consistent with the objectives of this title, to vest in public housing agencies that perform well the maximum amount of responsibility and flexibility in program administration with appropriate accountability to public housing residents, localities, and the general public.
10. HUD Directive 7460.8, REV-2 (Procurement Handbook), paragraph 3.5, states that public housing authorities must establish appropriate internal controls to ensure the proper expenditure of funds.
11. Paragraph 8 of the memorandum of agreement states that, if HUD determines that the housing agency has failed to meet the terms of or to make reasonable progress to execute or meet requirements in the agreement, the agency is in substantial default with the agreement. Paragraph 10 further states: "Notwithstanding anything to the contrary, upon occurrence of events or conditions that constitute a substantial default by the [housing agency] with respect to its obligations under the Annual Contributions Contract and applicable regulations to which the housing agency is subject or this MOA, HUD may, in its discretion," take various actions to replace management.
12. Section 17 of the consolidated annual contributions contract states that upon the occurrence of a substantial default by the Authority, as determined by HUD, HUD shall be entitled to any or all of the remedies set forth in the contract. Substantial default includes failure to maintain and operate the projects in decent, safe, and sanitary manner.