



Issue Date	January 26, 2011
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Audit Report Number	2011-FW-1006
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TO: Yolanda Chavez, Deputy Assistant Secretary for Grant Programs, DG

*//signed//*

FROM: Gerald R. Kirkland  
Regional Inspector General for Audit, Fort Worth Region, 6AGA

SUBJECT: The Texas Department of Housing and Community Affairs Generally Ensured  
That Its Program Management Firm Complied With Requirements

## **HIGHLIGHTS**

### **What We Audited and Why**

We audited the U. S. Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG), Supplemental II Disaster Recovery program funds, administered by the Texas Department of Housing and Community Affairs (TDHCA). Specifically, we wanted to determine whether TDHCA monitored its program management firm<sup>1</sup> (the Firm) to ensure compliance with Federal and State regulations and to ensure costs reimbursed for the Housing Assistance Program (HAP) and the Sabine Pass Restoration Program (SPRP) were adequately supported. This is the fourth audit of the Disaster Recovery funds awarded to the State of Texas, and it was conducted as part of the Office of Inspector General's (OIG) commitment to HUD to implement oversight of Disaster Recovery funds to prevent fraud, waste, and abuse.

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<sup>1</sup> ACS State and Local Solutions, Inc.

## What We Found

TDHCA's monitoring activities provided assurance that the Firm generally complied with Federal and State regulations. Further, TDHCA's reviews and monitoring generally ensured that program costs submitted for reimbursement by the Firm were adequately supported. However in a minor instance of noncompliance, TDHCA allowed the Firm to budget and receive reimbursement for a \$71,691 mark-up for "Admin Fees on Subcontractors" calculated using a "cost plus a percentage of cost method" that is not allowed under CDBG rules. TDHCA had originally questioned the costs but subsequently allowed them because contractor staff provided support that made the expenditures seem plausible to TDHCA.

## What We Recommend

We recommend that HUD's Deputy Assistance Secretary for Grant Programs require TDHCA to recover from the Firm all "Admin Fees on Subcontractors" costs, reimburse its HUD Disaster Recovery program accounts for those costs, and continue to monitor and review program disbursements for the ineligible cost plus a percentage of cost payments.

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 TDHCA our draft report on January 4, 2011, and requested its comments by January 20, 2011. We held an exit conference on January 18, 2011, with TDHCA and HUD. TDHCA provided its response to the draft report on January 19, 2011. It generally concurred. 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**

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Congress authorized two supplemental funding appropriations to assist the Gulf Coast States in recovering from the destruction of Hurricanes Katrina, Rita, and Wilma. Public Law 109-148 authorized \$11.5 billion (Supplemental I), and Public Law 109-234 (Supplemental II) authorized \$5.2 billion in Disaster Recovery program funding. Of the \$16.7 billion, the State of Texas (State) received \$503 million through the U. S. Department of Housing and Urban Development (HUD) Community Development Block Grant (CDBG) program to address areas most impacted by Hurricanes Rita and Katrina.

The Governor of Texas selected the Texas Department of Housing and Community Affairs (TDHCA) as the lead agency to administer the Disaster Recovery funds. TDHCA was established in 1991 as the State's primary agency to provide essential public service and housing needs for extremely low to moderate income individuals and families in Texas. TDHCA in conjunction with the State's Council of Governments distributed the Supplemental I funds for housing. TDHCA allocated \$232 million in Supplemental II funds to aid eligible homeowners to repair or replace their hurricane damaged homes. The Supplemental II funds were distributed for housing using a procured program management firm (Firm).

In December 2007, TDHCA contracted with the Firm, which subcontracted with Shaw Environmental, Inc. (Shaw), and Reznick, Mississippi, L.L.C. (Reznick), to administer the Housing Assistance Program (HAP) and the Sabine Pass Restoration Program (SPRP). The Firm was to be responsible for the distribution of \$232 million in Supplemental II housing aid to homeowners affected by the hurricanes. As of September 2010, the Firm reported that it had constructed or rehabilitated more than 2,000 homes with Supplemental II Disaster Recovery funds.

Our objective was to determine whether TDHCA monitored its program management firm to ensure compliance with Federal and State regulations and to ensure costs reimbursed for the HAP and the SPRP were adequately supported.

## RESULTS OF AUDIT

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### Finding: TDHCA Generally Ensured its Program Management Firm Complied With Requirements

TDHCA reviews and monitoring activities generally ensured that the Firm complied with Federal and State regulations and that program costs submitted for reimbursement were adequately supported. However, in a minor instance of noncompliance, TDHCA reimbursed the Firm \$71,691 for administrative costs that included a subcontractor's mark-up cost, which was based on a cost plus a percentage of cost payment type that is not allowed under CDBG rules. TDHCA had originally questioned the costs but subsequently allowed them because contractor staff provided support that made the expenditures seem plausible to TDHCA.

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#### **TDHCA's Monitoring Functions Were Independent and Organized**

TDHCA had a well organized and independent Office of Oversight and Asset Division (Compliance Division) that ensured the CDBG Disaster Recovery programs were administered in compliance with contract provisions and Federal and State rules, regulations, policies, and related statutes. TDHCA also established and implemented adequate oversight and monitoring procedures to ensure program and financial compliance. Onsite monitoring visits were scheduled based on risk assessments. TDHCA's Compliance Division had the primary role of monitoring the Firm's contract to ensure compliance with State and Federal requirements. The Compliance Division was independent of the Disaster Recovery Division and had conducted four formal monitoring reviews of the Firm and the HAP and SPRP. In addition, the Internal Audit Division had conducted a formal independent audit of some aspects of the Firm's contract. Further, the Disaster Recovery Division staff maintained daily communication with the Firm and had also conducted various reviews and monitoring visits.

#### **TDHCA Monitoring Activities Generally Ensured Compliance**

TDHCA's monitoring goals were to provide reasonable assurance that the Firm complied with Federal, State, and CDBG program requirements. Since the inception of the contract, the Compliance Division, Internal Audit Division, and Disaster Recovery Division have conducted at least 20 monitoring reviews resulting in 11 monitoring reports or letters, which included at least 12 findings, 28 issues or problems, and 8 observations. TDHCA also monitored the corrective actions taken

by the Firm. In addition, TDHCA and the Firm established invoice and payment procedures that generally provided adequate assurance that payment draws were supported, properly authorized, approved, and accurately reported in the accounting systems.

### **Cost Submitted for Reimbursement Were Generally Supported**

Eight separate draw downs totaling \$8.4 million, of the \$232 million allocated to the HAP and SPRP programs, were reviewed. About \$7.4 million of the draw downs consisted of administrative costs paid to the Firm. The review showed that the Firm's draw downs and TDHCA reimbursements were generally adequately supported; except for the payment of the ineligible mark-up costs of \$71,691<sup>2</sup> for "Admin Fees on Subcontractors."

In 2009, TDHCA's Compliance Division identified the "Admin Fees on Subcontractors" as unsupported. However, it later allowed the costs because they were included in the Firm's contract and budgeted as a subcontractor's costs.<sup>3</sup> Yet, the subcontractor's explanation clearly showed that mark-up for "Admin Fees on Subcontractors" was calculated using a cost plus a percentage of cost method. Although State policy allows a cost plus a percentage of cost payment type method,<sup>4</sup> HUD's State CDBG program regulations do not.<sup>5</sup>

### **Conclusion**

TDHCA reviews and monitoring activities generally ensured that the Firm generally complied with Federal and State regulations and that program costs submitted for reimbursement were adequately supported. In most cases, TDHCA's reviews detected and corrected problems, except in the minor case of the ineligible mark-up.

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<sup>2</sup> This amount represents less than .01% of the total draws reviewed ( $\$71,691/\$8.4 \text{ million} = .009$ )

<sup>3</sup> Reznick, Mississippi, L.L.C.

<sup>4</sup> Texas Contract Management Guide, chapter 3, Preparing the Solicitation, Payment Types

<sup>5</sup> 24 CFR (Code of Federal Regulations) 570.489(g)

## Recommendations

We recommend that HUD's Deputy Assistant Secretary for Grant Programs require TDHCA to

- 1A. Recover from the Firm, \$71,629 for the "Admin Fees on Subcontractors" costs, and reimburse the appropriate HUD Disaster Recovery Program accounts.
- 1B. Continue to monitor and review program disbursements for ineligible cost plus a percentage of cost payment types.

## SCOPE AND METHODOLOGY

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We conducted our audit work at the TDHCA's office in Austin, TX, at its Firm's office, in San Antonio, TX, and the HUD OIG's office in San Antonio, TX. We performed our audit work between August and November 2010. The audit generally covered the period December 2007 through August 2010. To accomplish our objective we:

- Reviewed the Federal Register, CDBG, Disaster Recovery grant for hurricane recovery.
- Reviewed HUD's community development block grant regulations.
- Reviewed HUD's and TDHCA's Disaster Grant agreement.
- Reviewed TDHCA's and the Firm's policies, guides, and action plans for the Disaster Recovery program, monitoring process, and payment processing.
- Reviewed the contract between TDHCA and the Firm and other documents concerning monitoring, payment, and reimbursement processing.
- Reviewed TDHCA's monitoring reports.
- Interviewed TDHCA's and the Firm's managers and staff.
- Reviewed eight separate draw requests totaling \$8.4 million and verified supporting documentation from source documents provided by TDHCA and the Firm.
- Performed tests of the computer-processed data obtained from the TDHCA and the Firm. We determined the data to be sufficiently reliable to meet our objective.

To accomplish our objective, we reviewed the Firm's costs submitted for reimbursement to verify that costs were adequately supported and included in the contract budgets. We selected and reviewed eight separate draw downs totaling \$8.4 million of the \$232 million allocated to HAP and SPRP, of which \$7.4 million included draws paid to the Firm for administrative costs. A statistical sampling method was not used to select the draw downs; instead, the selection was based on the results of a risk assessment and prior audit findings. Thus, any results or conclusions stated in this report, only apply to the draws reviewed and cannot be projected to the entire \$232 million allocated to the programs. The draws, supporting documentation, and invoices are maintained by the Firm. According to TDHCA staff, a complete or effective review of the draw down documentation was not possible or practical when processing administrative draws for the Firm and construction draws for over 2,500 planned homes in a timely manner. TDHCA's main justification was that the draw down documentation was voluminous. TDHCA's Disaster Recovery Division required the Firm to keep the hardcopies of the draws and supporting invoices on-site and reviewed them on a test basis during monitoring visits or when necessary.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.



# INTERNAL CONTROLS

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Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Monitoring review process
- Invoice and payment review process
- Proper execution and recording of transaction
- Appropriate documentation of transactions

We assessed the relevant controls identified above.

A deficiency in internal controls exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

## Significant Deficiency

We evaluated internal controls related to the audit objective in accordance with generally accepted government auditing standards. Our evaluation of internal controls was not designed to provide assurance regarding the effectiveness of the internal control structure as a whole. Accordingly, we do not express an opinion on the effectiveness of the TDHCA's internal controls.

## FOLLOW-UP ON PRIOR AUDITS

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**The Texas Department of  
Housing and Community  
Affairs Did Not Fully Follow  
Requirements or Best Practices  
in the Acquisition of Its Disaster  
Recovery-Funded Program  
Management Firm,  
2010-FW-1005**

We issued an audit report on the CDBG Supplemental II Disaster Recovery program funds in July 2010. The audit found that TDHCA did not follow requirements or best practices in the acquisition of its Disaster Recovery-funded program management firm. Specifically, it accepted and approved the only proposal received when the proposal's cost exceeded the request for proposals' specification by \$3.68 million. TDHCA made material changes to the contract that increased the maximum cost by \$1.99 million, budgeted \$210,000 in prohibited costs, and contracted to pay the Firm using multiple payment types including \$2.23 million for a cost plus a percentage of cost type, which is prohibited by Federal regulations. In addition, TDHCA's contract with the Firm lacked sufficient detail tying construction management services and oversight to the payment and budget section costs for the proper identification and allocation of \$14.33 million in costs. As a result, TDHCA could not ensure it received the best value to the State, and its contract included ineligible and unsupported costs of almost \$18.76 million. We recommended that HUD's Disaster Recovery Assistance and Special Issues Division Director require TDHCA to (1) adopt sound agency business procedures for Disaster Recovery-funded procurements in accordance with State policy, (2) train its staff members to ensure that they follow its policies, (3) reimburse its Disaster Recovery account for \$2.44 million in ineligible costs, (4) provide support for or reimburse \$16.32 million in unsupported costs, and (5) modify its contract language.

HUD agreed with all of the finding recommendations in the audit report. Based on the information provided by TDHCA, HUD indicated it would continue to work with TDHCA to ensure program compliance and to oversee the recommended actions for each finding. As of December 20, 2010, the recommendations are still in open status.

## APPENDIXES

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### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

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Recommendation number	Ineligible <u>1/</u>
1A	\$71,691


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

# Appendix B

## AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments

  
**TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS**  
*www.tdhca.state.tx.us*

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January 19, 2011

Mr. Gerald Kirkland  
U.S. Department of Housing and Urban Development  
Office of the Inspector General  
819 Taylor Street, Suite 13A09  
Fort Worth, Texas 76102

Re: Letter of January 4, 2010 regarding Draft Audit Report 2011-FW-100X


Dear Mr. Kirkland:

The Texas Department of Housing and Community Affairs (TDHCA) appreciates the work performed on the audit of TDHCA's monitoring and oversight function of Community Development Block Grant (CDBG) Disaster Recovery funds. We take our responsibilities seriously and appreciate HUD's recognition of the controls in place to oversee these much needed disaster recovery funds. As you know, TDHCA has built these new programs from the ground up, and we are continuously striving for improvements. We greatly appreciate HUD's recognition of our efforts to ensure that taxpayer dollars are used in the most efficient and effective ways possible.

Management generally concurs with the report and is in the process of recovering \$71,691 from the Program Management Firm as identified in the report.

Again we appreciate the favorable report and thank you for your careful review. TDHCA looks forward to its continued relationship with HUD.

Sincerely,



Michael Gerber  
Executive Director

MG:kc

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**Comment 1**

### **OIG Evaluation of Auditee Comments**

**Comment 1** TDHCA generally agreed with the audit report and is in the process of recovering the \$71,691 from the Firm. We acknowledge TDHCA's positive monitoring efforts and timely action in this matter.