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SUBJECT: The Housing Authority of the City of Eloy Lacked Capacity to Administer Its Recovery Act Capital Fund Grant Without Outside Assistance

HIGHLIGHTS

What We Audited and Why

We performed a capital fund administrative capacity review of the Housing Authority of the City of Eloy (Authority) because, despite the Authority's persistent management problems, the U.S. Department of Housing and Urban Development (HUD) awarded it a Public Housing Capital Fund grant of \$113,672 under the American Recovery and Reinvestment Act of 2009 (Recovery Act). Our objective was to determine whether the Authority had sufficient capacity to administer its Recovery Act Public Housing Capital Fund grant in accordance with applicable rules and regulations.

What We Found

The Authority did not, by itself, have the capacity to administer its Recovery Act Public Housing Capital Fund grant in accordance with applicable rules and regulations. HUD's Office of Public Housing had rated the Authority as troubled for years, and despite intensive technical assistance from HUD, the Authority had been unable to establish sound operational and financial management.

To address the Authority's inability to recover from its troubled status, HUD sought to establish an agreement for management assistance between the Authority and the Housing and Community Development Department for the City of Tucson (Tucson housing department). The Tucson housing department tentatively agreed, but in mid

September, 2009, HUD notified OIG that the Tucson housing department planned to decline participation due to staff changes. In addition to its effort to augment the Authority's overall management capacity, HUD was facilitating a partnership between the Authority and a nonprofit organization to provide needed capacity to administer Recovery Act projects. Without the proposed additional capacity that would be provided by the management agreement and the nonprofit partnership, the Recovery Act capital fund grant for the Authority would be at risk for waste, fraud, and abuse.

What We Recommend

We recommend that HUD approve a management assistance agreement for the Authority as quickly as possible, require a partnership agreement or contract that would provide additional capacity to manage the Recovery Act grant, and closely monitor all Recovery Act expenditures and deadlines.

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 the Authority a discussion draft report on September 03, 2009, and an exit conference with the appropriate officials was waived on September 24, 2009. A response to the report was not provided by the City of Eloy.

We provided the auditee the final report on September 25, 2009.

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BACKGROUND AND OBJECTIVE

The Housing Authority of the City of Eloy (Authority) is a small public housing authority with 50 public housing units, 159 Section 8 vouchers, and an operating staff of four. For fiscal year 2008, the Authority was funded as shown in the following table.

Public housing operating subsidy	\$163,210
Housing Choice Voucher program	\$742,322
Public Housing Capital Fund program	\$ 89,803
Total	\$995,335

The Public Housing Capital Fund program began in fiscal year 2000 and distributes funds annually based on a formula to all public housing authorities regardless of size. The purpose of the program is for the development, financing, and modernization of public housing developments and for management improvements. The funds may not be used for luxury improvements, direct social services, costs funded by other U.S. Department of Housing and Urban Development (HUD) programs, and ineligible activities as determined by HUD on a case-by-case basis.

For fiscal year 2009, the Authority was one of 15 Arizona public housing authorities that received additional capital grant funds under the American Recovery and Reinvestment Act of 2009 (Recovery Act). On March 18, 2009, HUD informed the Authority that it had approved the Recovery Act capital fund grant in the amount of \$113,672.

The Authority has a long history of mismanagement, and HUD's Office of Public Housing has rated one or more of the Authority's programs as troubled since 2002. Among other monitoring efforts, since June 2007 HUD has required the Authority to obtain HUD approval before all expenditures—excluding items involving emergency repairs that may affect the health and safety of the residents.

As a result of the long-standing troubled rating, problems with financial management, and the termination of the former executive director, HUD's Office of Inspector General (OIG) opened an audit of the Authority in 2007. The audit report (number 2008-LA-1009, issued May 5, 2008) found that the Authority did not have adequate internal controls to safeguard assets and ensure compliance with HUD's requirements and made five recommendations. As of August 2009, recommendation 1C of the audit report remained open. The original recommendation required HUD to conduct on-site monitoring until it determined that (1) the Authority was operating with adequate management and financial controls, (2) the board of commissioners was fully performing its fiduciary responsibilities, and (3) the Authority's financial condition was sound.

Our objective was to determine whether the Authority had sufficient capacity to administer the Public Housing Capital Fund grant it will receive under the Recovery Act.

RESULTS OF AUDIT

Finding 1: The Authority Lacked Management Capacity to Administer Its Recovery Act Capital Fund Grant Without Outside Assistance

The Authority had not resolved long-standing management problems despite intensive monitoring and technical assistance by HUD's Office of Public Housing. At the time of our review, the position of executive director was vacant, and the newly appointed board of commissioners was not functioning effectively. In July 2009, HUD officials sought to establish a management agreement with the Housing and Community Development Department for the City of Tucson (Tucson housing department). Under such an agreement, the Tucson housing department would provide management oversight to ensure effective internal controls and operations at the Authority; however, in mid September, 2009, HUD notified OIG that the Tucson housing department was unable to participate due to staff changes. Without the additional management capacity, the Recovery Act capital fund grant of \$113,672 awarded to the Authority would be at risk for waste, fraud, and abuse.

The Authority Was Unable to Resolve Management Problems

HUD's Office of Public Housing rated the Authority troubled for the fiscal years 2002 through 2007 because of low scores under the financial and management sections of HUD's Public Housing Assessment System. In addition, HUD rated the Authority "capital fund troubled" because it routinely used its capital grant funds to cover ineligible expenses.

OIG issued an audit report in May 2008 that recommended major management improvements. Later that year, a new board of commissioners (board) took over, and all Authority staff was replaced. Despite good intentions, technical assistance from HUD, and some improvement in operations, the new board continued to experience problems. Specifically, the new board was unable to recruit and retain a qualified executive director and, with the director position vacant, it could not manage day-to-day operations regarding maintenance and upkeep of its public housing units, let alone manage the capital fund program. For example, the board delayed its approval of purchase orders needed for rehabilitation of five public housing units that had been vacant since May 2009. Further, the Authority's staff did not have the knowledge or experience needed to create a scope of work for a large capital fund project. Finally, revisions to the Authority's procurement policy to conform with Recovery Act requirements had not yet been approved by the board. All of these issues raised questions regarding the Authority's ability to manage additional capital fund projects with its Recovery Act grant.

During our review, HUD determined that it was unable to close OIG's 2008 recommendation to conduct on-site monitoring until the management problems were fully resolved by the target date. On the July 31, 2009, target date, HUD and OIG agreed to revise recommendation 1C and moved the deadline to October 9, 2009. The revised management decision stated that, due to recent management and board changes, HUD and the Authority had agreed that the Authority would be better served if it was managed by another housing agency. The Authority would provide documentation in the form of a written statement that its programs would be administered by another housing agency with an acceptable performance record as determined by HUD. This change would ensure that adequate management and financial controls would be established for the Authority's programs and the board would exercise appropriate oversight of financial and program decisions.

The Authority Was in Transition

To address the revised OIG audit recommendation, HUD proposed that the Authority establish a management agreement with the Tucson housing department, which operates public housing and Housing Choice Voucher programs for the City of Tucson. The Tucson housing department tentatively agreed; however, as of September, 2009, HUD notified OIG that the Tucson housing department was unable to participate due to staff changes. Meanwhile, the Authority's board members resigned or were terminated in July, and the City of Eloy council members were temporarily appointed to serve on the Authority's board. The Eloy city manager was temporarily appointed as interim executive director. The Mayor of the City of Eloy has agreed to let another public housing agency manage the Authority.

The Recovery Act gave the Secretary of HUD discretion regarding the allocation of the capital fund grant funds to troubled housing authorities. Accordingly, HUD issued guidance stipulating that public housing authorities that are troubled under the Public Housing Assessment System and receive Recovery Act capital fund grants are subject to additional monitoring and oversight by HUD and its agents/contractors as deemed appropriate and necessary to ensure the proper use of Recovery Act grant funds (see criteria in appendix C).

A Proposed Partnership Would Provide Additional Oversight for Recovery Act Projects

Without additional management expertise, the Authority did not have the capacity to manage or administer the Recovery Act funds in accordance with applicable HUD rules and regulations. In recognition of the Authority's challenges to effective use of its Recovery Act grant, HUD officials sought to facilitate a partnership between the Authority and a nonprofit organization to manage Recovery Act projects. As of July 2009, the Authority was working to establish a partnership with the nonprofit agency

Community Action Human Resources Agency (Community Action) to use the Authority's Recovery Act capital fund grant for the upgrade and weatherization of 26 public housing units. Community Action received U.S. Department of Energy Recovery Act funds¹ that could also be used to weatherize the public housing units. HUD and the U.S. Department of Energy entered into a memorandum of understanding that would streamline the eligibility process for the recipients of the weatherization grants.

The partnership would benefit the Authority because Community Action could assist with the project management and also help to ensure that HUD and Recovery Act requirements would be met. Moreover, Community Action successfully partnered with another Arizona housing authority for a similar project that was recently completed. Although each agency would be responsible for its portion of the upgrade and/or weatherization work, Community Action had taken the lead for completing the administrative tasks, including writing the scope of work and administering all bidding and contracting functions. In addition, Community Action planned to provide the oversight of all rehabilitation work.

Conclusion

Unless the Authority enters into a documented agreement with another housing authority that can provide administrative capacity, the Authority's Recovery Act capital fund grant will be at risk for waste, fraud, and abuse. In addition, the Authority could have difficulty meeting the requirements and goals of the Recovery Act without the proposed partnership with a nonprofit that would provide administrative expertise for the proposed project. HUD will need to closely monitor the Authority to ensure that the proposed additional capacity is effectively implemented.

Recommendations

We recommend that the Director, Los Angeles Office of Public Housing,

- 1A. Review and, if appropriate, approve a management agreement with another housing authority or management entity as quickly as possible and if such an arrangement cannot be achieved, identify an alternative source of outside management assistance for the Authority.
- 1B. Require the Authority to partner or solicit for contractual services with another entity that will provide administrative expertise for the Recovery Act projects.
- 1C. Closely monitor the Authority and/or its responsible entity to ensure compliance with Recovery Act deadline and expenditure requirements.

¹ The U.S. Department of Energy provided the funds to the State of Arizona, which, in turn, approved the allocation of Recovery Act funds to Community Action through the State's Department of Commerce.

SCOPE AND METHODOLOGY

The period covered by the audit was March 1 through August 30, 2009. Our review was performed at the Authority's office at 100 West Phoenix Avenue in Eloy, Arizona, and at the HUD Phoenix Field Office. We performed our audit work from May 28 through August 12, 2009.

To perform our audit, we

- Reviewed applicable laws and regulations, other guidance issued by HUD, and Office of Management and Budget circulars;
- Reviewed the Authority's procurement policies and procedures;
- Reviewed HUD monitoring reports;
- Inspected five vacant public housing units;
- Interviewed staff from HUD's Office of Public Housing – Phoenix, Authority staff members, the Authority's board chair and one other board member, and a representative of Community Action; and
- Reviewed a prior HUD OIG audit report.

We limited our review to an understanding of the Authority's administrative capacity for procurement and capital project planning/oversight and examined a few procurement transactions to determine whether policies and controls were followed.

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

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

- Program operations,
- Relevance and reliability of information,
- Compliance with applicable laws and regulations, and
- Safeguarding of assets and resources.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. They 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.

Relevant Internal Controls

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

- Administering the program's operations in compliance with applicable laws and regulations.

We assessed the relevant controls identified above.

A significant weakness exists if internal 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 that the following item is a significant weakness:

- The Authority did not have adequate internal controls to reasonably ensure compliance with the Public Housing Capital Fund grant program requirements.

FOLLOW-UP ON PRIOR AUDITS

Housing Authority of the City of Eloy HUD OIG Report 2008-LA-1009

HUD OIG issued an audit report on the Authority (2008-LA-1009) in May 2008. The audit found that the Authority did not have adequate internal controls to safeguard assets and ensure compliance with HUD's public housing and Section 8 program requirements. As of August 2009, recommendation 1C, addressed to the Director of HUD's Los Angeles Office of Public Housing, remained open.

- 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.

In its management decision, HUD established a target date of July 31, 2009, for completion of the corrective action for recommendation 1C. During the past few months, it became apparent to HUD that the Authority would not achieve the goals under recommendation 1C by the deadline. On July 31, 2009, HUD and OIG agreed to revise the recommendation and moved the action target date from July 31 to October 9, 2009. The revised recommendation stated that due to recent management and board changes, both HUD and the Authority had agreed that the Authority would be better served if it was managed by another housing agency. The Authority will provide documentation in the form of a written statement that its programs will be administered by another public housing agency with an acceptable performance record as determined by HUD. This change will ensure that adequate management and financial controls will be established for the Authority's programs and the board of commissioners will exercise appropriate oversight of financial and program decisions.

APPENDICES

Appendix A

SCHEDULE OF FUNDS TO BE PUT TO BETTER USE

Recommendation number	Funds to be put to better use <u>1/</u>
1A	\$113,672

- 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. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

Appendix B

CRITERIA

1. Office of Management and Budget M-09-15: Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009

Section 6.4 states that the terms and conditions, beyond standard practice, that must be included in contract agreements under the Recovery Act include buy American requirements for construction material, reporting requirements, U.S. Government Accountability Office/Office of Inspector General access, and whistleblower protection.

Section 6.5 states that agencies already have in place processes and procedures to continuously monitor and improve the effectiveness of internal controls associated with their programs. In light of the Administration's commitment to high levels of accountability and transparency, special attention should be given to maintaining strong internal controls over the Recovery Act program funds.

2. American Recovery and Reinvestment Act [ARRA] - Appendix A: ARRA Funding and Requirements

“The purpose of the [Recovery] Act with regard to the Public Housing Capital Fund is to carry out capital and management activities for Public Housing agencies.

Public Housing agencies shall obligate 100 percent within one year, expend at least 60 percent within two years, and expend 100 percent within three years.”

3. American Recovery and Reinvestment Act: Department of Housing and Urban Development: Draft Program Recovery Plan Public Housing Capital Fund (Formula)

“PHAs [public housing agency] will give priority consideration to the rehabilitation of vacant rental units and prioritize projects that are already underway or included in the five year Capital Fund plans. Specific activities are those eligible under the Capital Fund, which include physical improvements such as new building systems (heat, water and electrical), structural systems (roofs and exteriors) and other renovation and rehabilitation work that corrects building deficiencies and improves living conditions for public housing residents.

“PHAs are expected to also undertake activities resulting in improved energy efficiency, reduced energy costs, and a lower carbon footprint. Activities include the use of Energy Star labeled appliances, weatherization, and the use of fuel efficient heating and air conditioning systems.”

4. HUD Public and Indian Housing Notice 2009-12 (HA), March 18, 2009

VI. Important Recovery Act Requirements

Use of Funds

“PHAs must use these funds on Capital Fund eligible activities currently identified in either their Annual Statement or Five-Year Action Plan. These funds are available to address deferred maintenance needs, including ... replacement of obsolete and equipment with energy efficient systems and equipment that reduces consumption.”

Troubled PHAs

“PHAs that are PHAS troubled under the Public Housing Assessment System (PHAS) will be subject to additional monitoring and oversight by HUD as deemed necessary to ensure proper use of the Capital Funds received under the Recovery Act....”