



John Keel, CPA
State Auditor

An Audit Report on

**Hurricane Recovery Funds
Administered by the Department
of Housing and Community
Affairs and the Office of Rural
Community Affairs**

October 2007

Report No. 08-005



An Audit Report on

Hurricane Recovery Funds Administered by the Department of Housing and Community Affairs and the Office of Rural Community Affairs

SAO Report No. 08-005
October 2007

Overall Conclusion

Two state agencies—the Department of Housing and Community Affairs and the Office of Rural Community Affairs—are responsible for administering \$523,669,701 in funds dedicated to the recovery from Hurricane Katrina and Hurricane Rita. Ninety-six percent of these funds were made available through two federal grants from the U.S. Department of Housing and Urban Development (see text box for additional details).

A summary of each agency's status in awarding these funds is presented below.

Status of Funds Allocated to Unmet Housing Needs and Administered by the Department of Housing and Community Affairs

The Department of Housing and Community Affairs has expended only \$1,102,249 (2.59 percent) of the \$42,589,054 in Community Development Block Grant funds the federal government initially awarded to it in May 2006 for hurricane recovery. Of the amount expended, \$231,066 (21 percent) has been used by the Department of Housing and Community Affairs for administrative expenses (see text box for additional details). As of September 14, 2007, only 13 applicants had benefited from a delivered product; all 13 applicants received manufactured homes.

The Department of Housing and Community Affairs was awarded additional Community Development Block Grant funds totaling \$386,671,849 in April 2007. However, it cannot spend those funds until the necessary contractual agreements are in place to administer the award.

The Department of Housing and Community Affairs also is responsible for administering an additional \$19,624,852 in non-Community Development Block Grant funds dedicated to hurricane recovery through its existing programs.

Background Information

The Department of Housing and Community Affairs and the Office of Rural Community Affairs are responsible for administering a total of \$523,669,701 in funds dedicated to the recovery from damages caused by Hurricane Katrina and Hurricane Rita.

While Hurricane Katrina did not make landfall in Texas, the state incurred costs when individuals affected by Hurricane Katrina were evacuated to Texas. Hurricane Katrina made landfall in Louisiana on August 29, 2005. Hurricane Rita made landfall in Texas less than one month later on September 24, 2005.

Administrative Expenditures

Auditors reviewed 65 percent of the Department of Housing and Community Affairs' \$231,066 in administrative expenses and determined that amount included:

- Salaries (78 percent of administrative expenses).
- Benefits (14 percent of administrative expenses).
- Travel (8 percent of administrative expenses).

This audit was conducted in accordance with Texas Government Code, Section 321.0131.

For more information regarding this report, please contact Mike Apperley, Assistant State Auditor, or John Keel, State Auditor, at (512) 936-9500.

The Department of Housing and Community Affairs has generally awarded funds for hurricane recovery in accordance with award criteria and requirements. However, auditors identified certain deficiencies related to the administration of these funds that the Department of Housing and Community Affairs should correct.

Table 1 summarizes the status of expenditures of the Department of Housing and Community Affairs' hurricane recovery funds.

Table 1

Status of the Expenditure of Department of Housing and Community Affairs Hurricane Recovery Funds (as of July 30, 2007)				
Program Used to Administer Funds	Total Funds Available	Date Funds Became Available	Amount Expended	Percent Expended
Community Development Block Grant (Round 1)	\$ 42,589,054	May 22, 2006	\$ 1,102,249	2.59%
Community Development Block Grant (Round 2)	386,671,849	April 13, 2007	0	0%
HOME Investment Partnership Program	14,111,224	\$9,347,224 on April 17, 2006 \$4,764,000 on December 1, 2006	618,035	4.38%
Bootstrap	1,892,800	\$1,268,800 on March 1, 2006 \$624,000 on June 1, 2006	91,400	4.83%
Tax Credits	3,620,828	April 26, 2006 - May 4, 2006	3,620,828	100%
Totals	\$ 448,885,755		\$ 5,432,512	1.21%

The Department of Housing and Community Affairs contracted with councils of governments to conduct a community development program for emergency relief in the Hurricane Rita disaster area, which included determining the eligibility of applicants for Community Development Block Grant hurricane recovery funds. The combined efforts of the Department of Housing and Community Affairs and the councils of governments have not moved applicants through the eligibility determination process within a reasonable time. Auditors reviewed 3,814 (89 percent) of the 4,299 applications for the Department of Housing and Community Affairs' initial Community Development Block Grant funds.¹ Approximately 44 percent of the applications reviewed were submitted before July 2006; approximately 85 percent of the 3,814 applications reviewed were submitted before February 2007. Many applicants are still living in some of the 4,249 trailers that the Federal Emergency Management Agency (FEMA) issued to Texas residents following Hurricane Rita.

Auditors also identified another less significant issue that was communicated separately in writing to the Department of Housing and Community Affairs.

¹ Not all of the 4,299 applications could be reviewed because of inconsistencies in data received from the councils of governments. The councils of governments provided application data that was downloaded from their application management systems.

Table 2 shows the status of applications for the Department of Housing and Community Affairs' initial Community Development Block Grant funds.

Table 2

Status of Applications for Department of Housing and Community Affairs Community Development Block Grant Funds (as of September 14, 2007)					
Council of Government	Minimum Number of Households to Assist	Application Status			Percent of Approved Applications to Program Capacity (Projected Minimum Households Assisted)
		Approved	Denied	Withdrawn	
Deep East Texas Council of Governments	348	1	13	21	0.3%
Houston-Galveston Area Council	441	12	11	1	2.7%
South East Texas Regional Planning Commission	229	22	264	76	9.6%
Totals	1,018	35	288	98	3.4%

Status of Funds Allocated to Infrastructure Needs and Administered by the Office of Rural Community Affairs

The Office of Rural Community Affairs was initially allocated \$31,933,946 in non-housing federal Community Development Block Grant funds for hurricane recovery. Approximately 46 percent of the non-housing subrecipient contracts the Office of Rural Community Affairs awarded to communities were originally intended to fulfill a 25 percent match for funds awarded by FEMA for hurricane-related public assistance expenses incurred by cities and counties. However, FEMA later determined it would fund 100 percent of these costs for public assistance projects; hazard mitigation project matching requirements remained unchanged.

The Office of Rural Community Affairs is now working with subrecipients to find other qualifying projects for its Community Development Block Grant funds. In many cases, the funds are now going toward projects that involve the purchase of generators for pump stations and shelter improvements. While only \$4,886,128 (15.3 percent) percent of the initial \$31,933,946 in Community Development Block Grant funding has been expended, it is important to note that the costs required to satisfy the most urgent infrastructure needs within communities have already been incurred by the communities and, in many cases, reimbursed by FEMA. The funds expended have been used to purchase emergency generators and sewer facilities; remove debris; repair streets, water wells, water lines, drainage systems, fire stations, water towers, and lift stations; restore and repair electrical systems; acquire and remove damaged structures; regrade roads and ditches; and replace culverts.

The Office of Rural Community Affairs was allocated additional Community Development Block Grant funds totaling \$42,000,000 in April 2007 to restore

critical infrastructure. As required by an action plan approved by the federal government,² \$19,800,000 of these funds are reserved for three projects, and the Office of Rural Community Affairs will award the remaining \$22,200,000 through a competitive selection process. The Office of Rural Community Affairs has not yet expended any of these funds.

The Office of Rural Community Affairs is responsible for administering an additional \$850,000 in non-Community Development Block Grant funds dedicated to hurricane recovery efforts through its existing programs. Auditors identified deficiencies related to the administration of these funds; however, the Office of Rural Community Affairs generally awarded funds for hurricane recovery in accordance with award criteria and requirements. Table 3 summarizes the status of Office of Rural Community Affairs' expenditures of hurricane recovery funds.

Table 3

Status of the Expenditure of Office of Rural and Community Affairs Hurricane Recovery Funds (as of July 30, 2007)				
Program Used to Administer Funds	Total Funds Available	Date Funds Became Available	Amount Expended	Percent Expended
Community Development Block Grant (Round 1)	\$ 31,933,946	May 22, 2006	\$ 4,886,128	15.3%
Community Development Block Grant (Round 2)	42,000,000	April 13, 2007	0	0.0%
Shelter Improvement	430,000	September 2005 to January 2006	277,771	64.6%
Rural Health	420,000	October 28, 2005	410,100	97.6%
Totals	\$ 74,783,946		\$ 5,573,999	7.5%

Key Points

The Department of Housing and Community Affairs should strengthen certain controls over its award and expenditure of Community Development Block Grant funds to prevent noncompliance with requirements that help to deter fraud, waste, and abuse.

Councils of governments with which the Department of Housing and Community Affairs contracted did not always maintain adequate supporting documentation used to determine eligibility for Community Development Block Grant funds or consistently calculate applicants' annual income.

Although the Department of Housing and Community Affairs has conducted monthly technical assistance visits at the councils of governments, it has not yet formalized

² See the *State of Texas Partial Action Plan for Disaster Recovery to Use Community Development Block Grant Funding*, April 13, 2007, prepared by the Department of Housing and Community Affairs and approved by the U.S. Department of Housing and Urban Development.

monitoring procedures in accordance with an action plan approved by the federal government.³

The Office of Rural Community Affairs should strengthen certain controls over its awards of Community Development Block Grant funds for hurricane recovery to prevent noncompliance with requirements that help to deter fraud, waste, and abuse.

The Office of Rural Community Affairs did not initially verify that subrecipients were not suspended or debarred from entering into contracts for Community Development Block Grant funds. The Office of Rural Community Affairs subsequently included language in the contracts to address this issue.

The Office of Rural Community Affairs has a policy to obtain and review evidence of all subrecipients' financial oversight prior to drawing down funds from the federal government. However, the action plan approved by the federal government requires this review to be done prior to awarding contracts to subrecipients. The Office of Rural Community Affairs did not consistently perform this review before it awarded Community Development Block Grant contracts.

The Office of Rural Community Affairs does not reconcile award information in its accounting system to information in its grants management system. Additionally, it reconciled its accounting system to the Uniform Statewide Accounting System, but it did not always perform these reconciliations in a timely manner.

Summary of Management's Response

The Department of Housing and Community Affairs and the Office of Rural Community Affairs generally agree with the recommendations in this report. Their responses to specific recommendations are presented in Chapters 1 and 2 of the report. An overall response from the Department of Housing and Community Affairs is presented in Appendix 3.

Summary of Objectives, Scope, and Methodology

The objectives of this audit were to determine whether the Department of Housing and Community Affairs and the Office of Rural Community Affairs appropriately awarded and disbursed hurricane recovery funds. Specific objectives were to:

- Determine whether hurricane recovery funds were awarded based on award criteria and requirements.
- Determine whether hurricane relief funds were disbursed in a timely manner.

The audit scope covered all matters related to the administration of the two awards of Community Development Block Grant funds for hurricane recovery, as

³ See *State of Texas Action Plan for CDBG Disaster Recovery Grantees under the Department of Defense Appropriations Act, 2006*, April 13, 2006, prepared jointly by the Department of Housing and Community Affairs and the Office of Rural Community Affairs and approved by the U.S. Department of Housing and Urban Development.

well as funds from other sources administered after September 1, 2005. The audit scope also included the automated systems and processes that support the functions being audited; however, audit work related to automated systems was limited to determining the reliability of the information in automated systems.

The audit methodology included collecting information and conducting interviews with staff at the Department of Housing and Community Affairs, Office of Rural Community Affairs, councils of governments, selected contract recipients, and contract administrators; performing selected tests and procedures; and analyzing and evaluating the results of the tests.

Contents

Detailed Results

Chapter 1	
The Department of Housing and Community Affairs Should Accelerate and Strengthen Certain Controls Over its Award and Expenditure of Hurricane Recovery Funds	1
Chapter 2	
The Office of Rural Community Affairs Should Strengthen Certain Controls Over Its Awards of Hurricane Recovery Funds	15

Appendices

Appendix 1	
Objectives, Scope, and Methodology	24
Appendix 2	
Distribution of Applications for Community Development Block Grant Funds	28
Appendix 3	
Department of Housing and Community Affairs' Overall Management Responses.....	29

Detailed Results

Chapter 1

The Department of Housing and Community Affairs Should Accelerate and Strengthen Certain Controls Over its Award and Expenditure of Hurricane Recovery Funds

The Department of Housing and Community Affairs generally administers funds for hurricane recovery in accordance with applicable requirements. However, it should accelerate and strengthen certain controls over its award and expenditure of funds for the following programs:

- Community Development Block Grant.
- HOME Investment Partnership Program (HOME Program).
- Bootstrap Program.

Chapter 1-A

As of September 14, 2007, Thirteen Homes Had Been Delivered Using Community Development Block Grant Funds Dedicated to Hurricane Recovery

To award Community Development Block Grant funds for hurricane

Community Development Block Grant Funds

The U.S. Department of Housing and Urban Development (HUD) awarded the first of two Community Development Block Grants dedicated to the recovery from damages caused by Hurricane Rita to the Department of Housing and Community Affairs on May 22, 2006.

To administer these funds, the Department of Housing and Community Affairs contracted with three councils of governments (subrecipients).

The councils of governments process applications and subcontract and monitor work for eligible applicants. The Department of Housing and Community Affairs' contracts with the following councils of governments commenced on July 28, 2006:

- Houston-Galveston Area Council.
- Deep East Texas Council of Governments.
- South East Texas Regional Planning Commission.

One of these councils of governments, the South East Texas Regional Planning Commission, contracted with the cities of Port Arthur and Beaumont as subrecipients to administer Community Development Block Grant funds.

recovery, the Department of Housing and Community Affairs contracted with three councils of governments. One of these councils of governments—the South East Texas Regional Planning Commission—then contracted with two subrecipient cities (see text box for additional details).

Community Development Block Grant funds were awarded to the Department of Housing and Community Affairs on May 22, 2006. As of September 14, 2007:

- Thirteen homes had been delivered using Community Development Block Grant funds.
- Based on data received from the councils of governments, a total of 4,299 applications had been submitted to the three councils of governments and the two subrecipient cities.

The Department of Housing and Community Affairs was initially allocated \$42,589,054 in Community Development Block Grant funds to address unmet housing needs resulting from Hurricane Rita. Of this amount, the Department of Housing and Community Affairs was responsible for

administering \$40,259,276, and the remaining \$2,329,778 was to be used for the Department of Housing and Community Affairs' administrative expenses.

Several factors have contributed to delays in awarding Community Development Block Grant funds.

Of the 4,299 applications that had been submitted as of September 14, 2007, the councils of governments had determined that 35 (1 percent) were eligible for assistance and 288 (7 percent) were ineligible. Of the remaining applications, 98 (2 percent) had been withdrawn and 3,878 (90 percent) were in various stages of the eligibility determination process.

Inadequate staffing dedicated to processing applications was a contributing factor to delays in processing applications at all three councils of governments. At one council of governments, applications were initially assigned to part-time caseworkers who met with the applicants to ensure that applications were completed correctly and to collect supporting documentation. Income eligibility was then determined by two other personnel, who performed these duties in addition to their regular job responsibilities. This contributed to the backlog of 2,013 applications, each of which was in various stages of the eligibility determination process. During this audit, this council of governments planned to add a third person to the income eligibility determination process.

The Department of Housing and Community Affairs cited several additional reasons for the slow progress in awarding Community Development Block Grant funds:

- The use of Community Development Block Grant funds for disaster recovery (administered by the Department of Housing and Community Affairs specifically for housing) was a new concept at the state level, and significant resources were required to develop and implement the action plan approved by the federal government.⁴
- The Department of Housing and Community Affairs diverted resources from administering the initial round of \$74,523,000 in Community Development Block Grant funding in order to secure the second round of \$428,671,849 in Community Development Block Grant funding.⁵
- Time was required to complete environmental and historical reviews of each property to be repaired.

⁴ See *State of Texas Action Plan for CDBG Disaster Recovery Grantees under the Department of Defense Appropriations Act, 2006*, April 13, 2006, prepared jointly by the Department of Housing and Community Affairs and the Office of Rural Community Affairs and approved by the U.S. Department of Housing and Urban Development.

⁵ The Department of Housing and Community Affairs is administering \$42,589,054 of the \$74,523,000 in initial Community Development Block Grant funding, while the Office of Rural Community Affairs is administering the remainder.

- Before the Department of Housing and Community Affairs contracted with the councils of governments, its board had to review and approve the budgets each council of governments submitted.

The Department of Housing and Community Affairs should make improvements in the eligibility determination process for Community Development Block Grant funds to prevent noncompliance with requirements that help to deter fraud, waste, and abuse.

Councils of governments generally approved and disapproved the applications for Community Development Block Grant funds for hurricane recovery in accordance with existing award criteria and policies; however, certain issues should be corrected:

- Councils of governments did not always maintain adequate supporting documentation used to determine eligibility. According to the Department of Housing and Community Affairs' *Housing Implementation Manual*, an adequate recordkeeping and filing system is essential to document compliance with applicable regulations and accomplishment of program activities. Councils of governments must control the grant funds and establish adequate safeguards to protect records that document all Community Development Block Grant transactions.
- Auditors tested 37 application files (for 13 approved applications and 24 disapproved applications) at the three councils of governments and identified the following:
 - ♦ One council of governments did not have adequate documentation to support the income eligibility of 1 (7.7 percent) of the 13 approved applications.
 - ♦ Documentation in files for the disapproved applications at one council of governments showed this organization used inconsistent methods to calculate applicants' annual income. This may have resulted in at least two eligible applicants being incorrectly deemed ineligible.

When eligibility determination processes are not applied adequately and consistently at the Department of Housing and Community Affairs and councils of governments, this increases the risk of incorrect eligibility determination. This could lead to questioned costs or eligible applicants being denied benefits that they are entitled to receive.

The Department of Housing and Community Affairs should establish and implement monitoring procedures for its oversight of councils of governments.

The Department of Housing and Community Affairs performs monthly technical assistance visits at the councils of governments to provide guidance related to administering Community Development Block Grant funds for

hurricane recovery. However, these visits are not specifically designed to determine whether councils of governments comply with requirements related to the award of Community Development Block Grant funds.

In January 2007, the Department of Housing and Community Affairs conducted monitoring visits at all three councils of governments to review these organizations' administrative expenditures. While this was prudent, the action plan approved by the federal government also required the Department of Housing and Community Affairs to modify its current monitoring procedures to specifically address the requirements of the Community Development Block Grant program and ensure that all contracts funded under the disaster recovery allocation were carried out in accordance with federal and state laws, rules, and regulations. The Department of Housing and Community Affairs has not yet developed and implemented these monitoring procedures. According to program management, the Department of Housing and Community Affairs placed a higher priority on delivering homes to applicants than it did on developing written monitoring procedures for the Community Development Block Grant program.

As the Department of Housing and Community Affairs expects project-related expenditures to increase, it will be important for the Department of Housing and Community Affairs to develop and implement monitoring procedures in accordance with the action plan approved by the federal government so that it can detect and prevent noncompliance with program requirements. According to the action plan, these monitoring procedures should include procedures to ensure that there is no duplication of benefits for projects that have otherwise been funded by the Federal Emergency Management Agency, private insurance, or any other funding source.

The State received an additional \$428,671,849 in Community Development Block Grant funds for hurricane recovery in April 2007.

On April 13, 2007, the U.S. Department of Housing and Urban Development (HUD) awarded the State \$428,671,849 in additional Community Development Block Grant funds for hurricane recovery. Of that amount, \$368,671,849 was dedicated to activities described in the action plan approved by the federal government,⁶ and the remaining \$60,000,000 was made available to the City of Houston and Harris County. See Table 4 for additional information on the distribution of the \$428,671,849.

⁶ See the *State of Texas Partial Action Plan for Disaster Recovery to Use Community Development Block Grant Funding*, April 13, 2007, prepared by the Department of Housing and Community Affairs and approved by the U.S. Department of Housing and Urban Development.

Table 4

Distribution of the Second Round of Community Development Block Grant Funds for Hurricane Recovery		
Activity	Available Funding for Activity	Percent of Total
Homeowner Assistance Program	\$210,371,273	49.1%
Sabine Pass Restoration Program	12,000,000	2.8%
Rental Housing Stock Restoration Program	82,866,984	19.3%
City of Houston and Harris County Public Service and Community Development Program	60,000,000	14.0%
Restoration of Critical Infrastructure Program ^a	42,000,000	9.8%
State Administration Funds	21,433,592	5.0%
Totals	\$428,671,849	100.0%
^a This program will be administered by the Office of Rural Community Affairs.		

Source: *State of Texas Partial Action Plan for Disaster Recovery to Use Community Development Block Grant Funding to Assist with the Recovery of Distressed Areas Related to Consequences of Hurricanes Katrina, Rita, and Wilma in the Gulf of Mexico in 2005*, April 13, 2007, prepared by the Department of Housing and Community Affairs and approved by the U.S. Department of Housing and Urban Development.

Homeowner Assistance Program and Sabine Pass Restoration Programs. The Department of Housing and Community Affairs intends to subcontract with a program management firm to administer the Homeowner Assistance Program and the Sabine Pass Restoration Program, which together total \$222,371,273 and account for more than half of the total additional Community Development Block Grant funding. On August 23, 2007, the Department of Housing and Community Affairs' board approved the selection of ACS, State and Local Solutions, Inc. as the subcontractor, which enabled the Department of Housing and Community Affairs to begin contract negotiations.

Rental Housing Stock Restoration Program. The \$82,866,984 for the Rental Housing Stock Restoration Program is intended for grants or loans to the owners of affordable rental properties that were damaged by Hurricane Rita. Applications for this program were due on July 26, 2007. At its September 13, 2007, meeting, the Department of Housing and Community Affairs' board awarded \$81,147,333 to five applicants.

Office of Rural Community Affairs funding. The Office of Rural Community Affairs will administer \$42,000,000 dedicated to the restoration of critical infrastructure through a contract with the Department of Housing and Community Affairs. As of September 21, 2007, the Department of Housing and Community Affairs and the Office of Rural Community Affairs had not entered into this contract. The Office of Rural Community Affairs has reserved \$6,000,000 of this funding for restoration and reconstruction of Memorial Hermann Baptist Orange Hospital; \$3,800,000 for Bridge City water infrastructure projects; and \$10,000,000 for a Hardin County drainage

restoration project. The Office of Rural Community Affairs issued a notice of funding availability for the remaining \$22,200,000 and intends to award those funds on a competitive basis.

City of Houston and Harris County funding. Of the \$60,000,000 awarded to them, the City of Houston and Harris County plan to use \$20,000,000 for each of the following programs: the Neighborhoods to Standards Program, the Multi-Family Apartment Community Liaison Program, and Evacuee Public Services. These funds will be used for the following purposes:

- Provide safe, sanitary affordable housing for displaced evacuees, including evacuees with special needs.
- Implement a coordinated housing safety program to promote community development and decrease crime in communities where evacuees have resettled.
- Address costs incurred in providing necessary emergency and non-emergency medical services provided to evacuees immediately following the disasters and in the following months.
- Provide necessary crisis counseling and case management to evacuees who continue to face extreme transition emergencies.
- Address the public service needs of special populations.

Recommendations

The Department of Housing and Community Affairs should:

- Continue to coordinate with councils of governments to identify and eliminate bottlenecks in the eligibility determination process for Community Development Block Grant hurricane recovery funds.
- Ensure that councils of governments have adequate staffing resources dedicated to administering the Community Development Block Grant hurricane recovery funds.
- Provide councils of governments with consistent written guidance related to maintaining adequate documentation used to make income eligibility determinations for Community Development Block Grant hurricane recovery funds (examples of documentation include pay stub information, tax returns, and documents related to property eligibility and environmental clearances). The Department of Housing and Community Affairs also should ensure that councils of governments adhere to the prescribed state and federal guidance in awarding Community Development Block Grant funds.

- Ensure that councils of governments apply consistent and approved methods to calculate the annualized income of applicants for Community Development Block Grant hurricane recovery funds.
- Develop and implement monitoring policies to ensure that councils of governments comply with Community Development Block Grant requirements and contractual obligations. These policies also should detail a process to determine whether applicants have received assistance from multiple agencies for the same damage claims.
- Implement all recommendations related to councils of governments' oversight listed above when it monitors the program management firm with which it intends to contract to administer the \$222,371,273 from the second round of Community Development Block Grant funding.

Management's Response

- *The Department concurs with the challenges that have been identified with implementing a program of this magnitude. The Department has had an open dialogue with the Councils of Governments (COGs) since the program's inception. The Division takes the challenges identified, conducts research, develops the most appropriate resolution to each challenge, and presents those solutions to the COGs to resolve the issues at hand. The Division will continue to be engaged with the COGs on an ongoing basis to ensure the program continues to move forward.*

The Division recently established benchmarks for each COG to ensure that the level of assistance (housing) proportionately increases in relation to the number of applicants that are certified as eligible. Target Date for Completion: Completed.

- *The Department agrees that each COG should allocate the resources necessary to administer their programs effectively and in accordance with the State Action Plan and contractual terms. The COGs are required to allocate staffing resources that best fits their individual needs through the use of administrative funds budgeted for this purpose and other resources available in each COG. The Division will continue to encourage the COGs to evaluate their staffing needs on an ongoing basis and provide staffing resources that are commensurate with the administration of the program. Target Date for Completion: Completed.*
- *The Department agrees that written guidance is essential to ensure documentation supports program activities. The Community Development Block Grant (CDBG) Disaster Recovery Housing Implementation Manual (manual) was first provided to the council of governments in August 2006, was modified twice, and was formally updated in September 2007. The*

Division identified all the activities of the CDBG program, developed forms and defined requirements, procedures and guidance that not only include eligibility but every component of the program. In addition to state and federal requirements, the manual will be used as a monitoring resource and reference guide to ensure compliance with all rules and regulations to coincide with the implementation of the CDBG monitoring policies and procedures. Target Date for Completion: Completed.

- *The Department agrees that the COGs must calculate income consistently and in accordance with the method used to determine the annualized income of applicants. The Department will ensure that income is calculated correctly as part of its monitoring responsibilities that will be formalized through written policies and procedures. Target Date for Completion: December 31, 2007. Person Responsible: Contract Administration Coordinator.*
- *The Department concurs with the requirement to develop and implement monitoring policies and procedures for the CDBG program to ensure compliance with requirements and contractual obligations. Informal monitoring tools, processes, policies and procedures have been developed that include a process for ensuring applicant eligibility. In addition, the Department's set-up and draw processes act as oversight controls used to review eligibility documentation before program funds are expended. The Department will finalize its monitoring methodologies in formal monitoring policies and procedures. Target Date for Completion: December 31, 2007. Person Responsible: Contract Administration Coordinator.*
- *As of October 2007, the Division has completed the procurement process for the second round of Community Development Block Grant funding and has initiated contract negotiations with its winning bidder. The State Action Plan provides specific guidance for Round I and II, however, the Department will determine if any first round recommendations impact the second round and will determine what additional compensating controls should be implemented.*

During This Audit, the Department of Housing and Community Affairs Accelerated the Award of HOME Program Funds for Hurricane Relief, But It Should Strengthen Certain Controls Over the Award and Expenditure of These Funds

HOME Program Hurricane Recovery Funds

HOME Program disaster funds are used for the repair, rehabilitation, and reconstruction of low income individuals' homes affected by the natural disaster. Emphasis is placed on assisting individuals who have no other means of assistance.

On April 17, 2006, the Department of Housing and Community Affairs awarded \$9,347,224 through its initial HOME Program contracts for hurricane recovery to 12 cities and counties. The first home was delivered through this program in June 2007. As of September 10, 2007, 15 manufactured homes had been delivered through the HOME Program.

Several factors contributed to delays in delivering HOME Program benefits for hurricane recovery:

- The HOME Program, which was traditionally a grant program, was changed to a loan program by the Department of Housing and Community Affairs' board on February 15, 2006. This change was made for the HOME Program as a whole, and hurricane recovery applicants were subject to virtually the same requirements to which all other HOME Program applicants were subject. To ease the burden on applicants with the fewest financial resources, the board made an exception to the loan program for all applicants with incomes below the "30 percent low-to-moderate income" level; these individuals became eligible to receive grants, and the process was streamlined for them.
- The change to a loan-based program increased the complexity of the HOME Program's administrative requirements. The timing of this change also coincided with the award of HOME Program funds for hurricane recovery. Unfamiliarity with the new loan process led to delays on the part of Department of Housing and Community Affairs staff and on the part of consultants hired by the cities and counties to administer HOME Program contracts that the Department of Housing and Community Affairs awarded.
- The Department of Housing and Community Affairs' organizational structure also contributed to some instances in which the Department of Housing and Community Affairs provided inconsistent guidance to contract administrators. The Department of Housing and Community Affairs is currently reorganizing so that all significant HOME Program processes are under the responsibility of the Department of Housing and Community Affairs' HOME Program director. This should lead to more consistent and streamlined information being provided to HOME Program contract administrators.

- According to HOME Program contract administrators, property inheritance issues also contributed to the delays in administering HOME Program contracts for hurricane recovery. One HOME Program contract administrator spent seven months resolving property inheritance issues identified during the title clearance process.

Despite these difficulties, several cities and counties to which HOME Program funds were awarded are nearing the delivery of completed homes at approximately the same time. In August 2007, a HOME Program contract administrator for Jasper County ordered all six manufactured homes that can be funded with its contract. The contract administrator anticipated the need for a second contract extension in order to close on the homes after they were delivered. The contract extension request estimated that delivery of the homes would be in October 2007.

The Department of Housing and Community Affairs should ensure that it secures environmental clearances and validates all costs on invoices that contractors submit.

The Department of Housing and Community Affairs generally administers HOME Program hurricane recovery funds in accordance with established requirements. However, it should strengthen certain controls over the award and expenditure of these funds to prevent noncompliance with federal and state requirements that help to deter fraud, waste, and abuse.

Construction or replacement costs were incurred before the environmental clearance was secured for 1 of 12 (8 percent) HOME Program project expenditures auditors tested. According to the Department of Housing and Community Affairs' *Owner Occupied Assistance* manual related to environmental clearance, an environmental review is mandatory and must be completed before a commitment or expenditure is made for any type of construction or rehabilitation; or before a physical action is taken on a site. Proceeding with construction and replacement prior to receiving environmental clearances increases the risk that funds could be spent on a home site that cannot be environmentally cleared.

In addition, the amount invoiced to and reimbursed by the Department of Housing and Community Affairs was overstated by \$60 for 1 of 13 (8 percent) HOME Program project expenditures auditors tested. This occurred because the contractor overcharged for skirting material based on the size of the home. Although the amount of this overcharge is not significant, as the HOME Program expenditures for hurricane recovery increase, the sum of potential overcharges (whether intentional or not) could become significant.

Before determining eligibility for HOME Program funds, the Department of Housing and Community Affairs should ensure that all property owners are listed on the application for funds.

For 1 of 12 (8 percent) HOME Program applications auditors tested, only one of two property owners was listed on the application (the other property owner was incarcerated when the application was submitted). Not listing all property owners on HOME Program applications could leave the Department of Housing and Community Affairs liable for demolishing property without obtaining approval from all property owners. In the case of this application, the damaged home was demolished to make way for new construction, and the demolition approval form was signed by only one of the two property owners.

Recommendations

The Department of Housing and Community Affairs should:

- Continue efforts to accelerate the expenditure of HOME Program funds for hurricane recovery.
- Implement its plans to align all significant responsibilities pertaining to the HOME Program within the chain of command of the HOME Program director.
- Ensure that it secures environmental clearances before incurring reconstruction or replacement costs for projects funded with HOME Program funds.
- Ensure that its staff validates all costs on invoices that contractors submit for projects funded with HOME Program funds, and compare those costs with amounts allowed under the contract.
- Ensure that all property owners are listed on applications for HOME Program funds (and particularly on the demolition approval form within the application).

Management's Response

Effective October 1, 2007, the HOME Division was reorganized to make operational improvements to the HOME Program and incorporate the administration of all non-monitoring aspects of the State's HOME Program. The purpose of the reorganization is to offer an efficient operation, including the provision of more technical assistance, by consolidating all processes under one central area. From program design, release of funding announcements, application intake, contract generation, project setups,

disbursements, and contract close-out, the HOME staff will be working together and under the leadership of the Division Director to assist Contract Administrators in the production of quality affordable housing.

A newly created team within the Division will provide technical assistance to HOME Contract Administrators and is comprised of a Performance Manager and six Performance Specialists. This team will also provide oversight and performance management of the Administrators to ensure timely and contractually-compliant completion of activities. The HOME Program contracts serving persons affected by Hurricane Rita have been prioritized by this team and will be assigned a Performance Specialist. Target Date for Completion: October 31, 2007. Person Responsible: HOME Division Performance Manager.

The HOME Division staff will continue to ensure that Contract Administrators meet all of the requirements of the HOME Program including obtaining environmental clearance prior to incurring construction costs, disbursement requests for validated costs, and requiring all property owners be listed on the application and provide approval of demolition. HOME Division staff will ensure compliance through desk-reviews performed on the review and approval process for setups and disbursements. Additionally, the Portfolio Management and Compliance Division staff will ensure compliance with all requirements through desk and on-site monitoring reviews. The HOME Division staff will issue a listserv announcement to remind Administrators of these requirements. Target Date for Completion: November 15, 2007. Person Responsible: HOME Division TA and Training Coordinator.

Chapter 1-C

Only One of Three Non-profit Organizations Had Expended Hurricane Recovery Funds on Home Improvements Through the Department of Housing and Community Affairs' Bootstrap Program as of August 14, 2007

The Department of Housing and Community Affairs contracted with three

Bootstrap Program

Through its Bootstrap Program, the Department of Housing and Community Affairs awarded \$1,892,800 for hurricane recovery to three non-profit organizations. Recipients of Bootstrap Program funds must make the majority of repairs by investing "sweat equity."

Under the program's rules, the Department of Housing and Community Affairs can loan up to \$30,000. If owners require additional funds to complete construction, they may secure matching funds from other sources not to exceed \$60,000 in total loan funds.

non-profit organizations to award hurricane recovery funds through its Bootstrap Program (see text box for details). As of August 14, 2007, only one of those organizations had expended Bootstrap Program funds on home improvements. Specifically, that non-profit organization has expended \$79,400 (16 percent) of the \$488,800 in total Bootstrap Program funds awarded to the organization and dedicated to hurricane recovery.

Two non-profit organizations had not provided any assistance to homeowners because of issues in staffing and

in securing matching funds from other sources when required. For example, one of these two organizations has had three different executive directors since it contracted with the Department of Housing and Community Affairs to implement the Bootstrap Program in June 2006. Additionally, one of this organization's previous executive directors did not communicate critical information to staff. This resulted in staff committing resources to selecting applicants who they thought were eligible, only to learn later that these individuals were not eligible because they were requesting loan funds from other sources that would exceed the combined \$60,000 limit.

Four of eight (50 percent) applications that auditors tested for Bootstrap Program eligibility did not include the owner-builder education certificate as required by Title 10, Texas Administrative Code, Section 2.13. Owner-builders that have not been properly trained in homebuilding techniques may decrease the benefits derived from the program, which could lead to safety or compliance issues.

Recommendations

The Department of Housing and Community Affairs should:

- Identify and eliminate bottlenecks delaying the delivery of hurricane recovery funds through the Bootstrap Program.
- Deobligate Bootstrap Program funds awarded to organizations that cannot fulfill their responsibilities and reallocate those funds to other organizations that can fulfill program requirements. Alternatively, it should reallocate Bootstrap Program funds to another program capable of delivering hurricane recovery funds to eligible individuals.
- Ensure that Bootstrap Program participants obtain the required owner-builder education certificates and that the Department of Housing and Community Affairs maintains this documentation.

Management's Response

- *The principal delays in delivering hurricane recovery funds to the affected populations through the Bootstrap Program resulted from unforeseen capacity issues including inexperience with the program, personnel issues, and lack of experience with self-help construction methodologies on behalf of the nonprofit organizations. Difficulties in obtaining leveraged funds from other sources – a virtual necessity due to program funding caps, have also hindered the production of homes. OCI staff will continue to work closely with the organizations awarded funding and to assist them*

in the administration of the program. Target Date for Completion: March 31, 2008. Person Responsible: Director of OCI.

- *OCI staff will be recommending that funds be deobligated from nonperforming contracts. OCI staff will also recommend to the Executive Director and the Department's Governing Board that these deobligated funds be placed into the Reservation System with a set-aside for counties that were affected by Hurricane Rita. This move is expected to increase the pool of participating organizations and decrease the obligations to a more manageable size for grassroots organizations. In order for a nonprofit organization to access these funds, the organization must be certified by the Department as a Nonprofit Owner-Builder Housing Provider (NOHP) and execute a Loan Origination Agreement with the Department. Target Date for Completion: December 31, 2007. Person Responsible: Director of OCI*

- *Participants are required to complete a homebuyer education class in order to participate in the program. In most cases this is an ongoing class conducted during the time period leading up to the funding of the loan. If a certificate is not enclosed with the Application/Compliance package, it will be part of the deficiencies noted in either the Applicant Eligibility Letter and/or the Applicant Suspense Notification Letter. Nonprofit organizations are informed of the requirement to submit this documentation in Section 2.13(6) of the Texas Bootstrap Loan Program Rules and Section 2.9 of the Texas Bootstrap Loan Program Contract between the Department and the nonprofit organization. TDHCA will maintain the certificates in the contract files in accordance with program record retention policies. Target Date for Completion: Completed. (Certificates are already in file. All files have the certificate in the files prior to final disbursement.)*

The Office of Rural Community Affairs Should Strengthen Certain Controls Over Its Awards of Hurricane Recovery Funds

The Office of Rural Community Affairs generally administers funds for hurricane recovery in accordance with applicable requirements. However, it should strengthen certain controls over its awards of funds from the following programs to improve assurance that it complies with all requirements:

- Non-housing Community Development Block Grant.
- Rural Health Disaster Relief and Recovery Grant.
- Public Shelter Improvement Program.

Chapter 2-A

The Office of Rural Community Affairs Should Strengthen Certain Controls Over Its Awards of Non-housing Community Development Block Grant Funds to Prevent Noncompliance with Requirements that Help to Deter Fraud, Waste, and Abuse

The Office of Rural Community Affairs generally administers non-housing Community Development Block Grant funds in accordance with federal Community Development Block Grant requirements and action plan approved by the federal government.⁷ However, it should strengthen certain controls over the award and expenditure of these funds.

Eligible Uses for Non-housing CDBG Funds

Eligible uses for non-housing Community Development Block Grant funds include the following:

- Federal Emergency Management Agency (FEMA) Infrastructure Grant Program matching funds.
- FEMA Hazard Mitigation Program matching funds.
- U.S. Natural Resource and Conservation Service flood and drainage projects.
- Roads and bridges.
- Water control facilities and water and wastewater facilities.
- Utilities.
- Parks and recreational facilities.
- Debris removal.
- Public and community shelters.

The Office of Rural Community Affairs was initially allocated \$31,933,946 in Community Development Block Grant funds to assist eligible communities with non-housing needs resulting from Hurricane Rita. Of this amount, the Office of Rural Community Affairs was responsible for administering \$30,537,574 (see text box for additional details); the remaining \$1,396,372 was to be used for the Office of Rural Community Affairs' administrative expenses.

Approximately 45 of the 98 (46 percent) non-housing Community Development Block Grant subrecipient contracts the Office of Rural Community Affairs awarded to communities were originally intended to fulfill a 25 percent matching requirement for funds awarded by the Federal

⁷ See *State of Texas Action Plan for CDBG Disaster Recovery Grantees under the Department of Defense Appropriations Act, 2006*, April 13, 2006, prepared jointly by the Department of Housing and Community Affairs and the Office of Rural Community Affairs and approved by the U.S. Department of Housing and Urban Development.

Emergency Management Agency (FEMA) for repair of hurricane-related infrastructure damages caused by Hurricane Rita. However, FEMA later determined it would fund 100 percent of the eligible public assistance projects. As a result of this change, the Office of Rural Community Affairs suspended payments under these contracts and began working with the affected communities to find other qualified projects for these Community Development Block Grant funds.

The Office of Rural Community Affairs should maintain documentation of its verification that subrecipients are not suspended or debarred.

When awarding contracts from the first round of Community Development Block Grant funds, the Office of Rural Community Affairs did not verify that subrecipients were not suspended or debarred from entering into contracts. After the Office of Rural Community Affairs awarded the first round of Community Development Block Grant funds, it began issuing contracts with subrecipients that included language that represented a certification from the subrecipients that they were not suspended or debarred. Title 24, Code of Federal Regulations, Part 24, specifies that entities that are debarred, suspended, or otherwise excluded from or ineligible for federal assistance programs cannot participate in federally funded transactions. By not verifying the suspension and debarment status, the Office of Rural Community Affairs risked contracting with ineligible subrecipients, which could lead to a loss of funds.

The Office of Rural Community Affairs should consistently verify that subrecipients provide evidence of sufficient oversight of their financial processes before it awards contracts.

The Office of Rural Community Affairs has a policy to obtain and review evidence of all subrecipients' financial oversight prior to drawing down funds from the federal government. However, the action plan approved by the federal government requires this review to be done prior to awarding contracts to subrecipients. The Office of Rural Community Affairs did not consistently perform this review before it awarded Community Development Block Grant contracts.

Five of 19 (26 percent) subrecipient files tested did not include evidence indicating that the Office of Rural Community Affairs conducted this verification before it awarded contracts.

The Office of Rural Community Affairs performed the following procedures to verify whether subrecipients performed sufficient oversight of their financial processes:

- If the Office of Rural Community Affairs had a prior relationship with a subrecipient that involved the administration of other Community

Development Block Grant funds, it considered the subrecipient's past financial stability as an indicator of financial oversight.

- The Office of Rural Community Affairs used a contract routing sheet to determine whether any issues were present prior to contracting. The contract routing sheet indicated that the Office of Rural Community Affairs considered project management, audit, and monitoring issues; however, the Office of Rural Community Affairs did not document the specific evidence it reviewed in determining whether there were outstanding issues.

Although the above procedures help to identify potential issues with subrecipient financial oversight, they do not meet the requirements of the action plan approved by the federal government, which requires that all applicants must include evidence of "sufficient financial oversight as established by an Independent Auditor's Report from 2004, or if applicable, 2005, audited financial statements for each subrecipient." This evidence is required at the time of application. The risk of loss or misuse of funds is increased when, prior to awarding contracts, the Office of Rural Community Affairs does not consistently verify that subrecipients provide evidence of sufficient financial oversight.

Recommendations

The Office of Rural Community Affairs should:

- Document its verification that Community Development Block Grant subrecipients are not suspended or debarred before it awards contracts.
- Develop and implement a process to consistently verify that Community Development Block Grant subrecipients provide evidence of sufficient oversight of their financial processes.

Management's Response

- *As documented in the report, the Office of Rural Community Affairs has included certification language in all new contracts that would satisfy the requirement for verifying a city, county, or federally-recognized tribe is not suspended or debarred. While the agency has adjusted the process to include the necessary certification in its standard CDBG contract, it also recognizes that it is highly unlikely that a city or county government would have been suspended or debarred and therefore the potential risk was quite minimal. In addition, we note that the agency has always verified and confirmed that construction contractors who work on the CDBG*

projects, including these disaster recovery projects, have not been suspended or debarred.

- *As documented in this report, the Office of Rural Community Affairs had a policy of obtaining and reviewing evidence of all subrecipients' financial oversight prior to disbursing any disaster recovery funds to subrecipients. We agree that the agency obtained some of the information prior to the disbursement of federal funds rather than at the application stage. The method the agency used has proven over the years to be a very effective process of verifying a subrecipient's financial oversight for all of the Texas CDBG program contracts. The method allows for timely and efficient processing of applications and contracts yet ensures that no federal dollars are actually disbursed to any city or county government prior to complete verification.*

The agency wanted to retain a verification process that was both familiar to the cities and counties who received these disaster recovery CDBG funds while still providing the necessary verification. Throughout its delivery of the non-housing disaster recovery funds, the agency made it very clear that it intended to employ its standard, time-proven method of delivering CDBG funds through contracts to individual cities and counties.

The agency provided additional clarification that it would apply this standard TxCDBG method of verifying financial oversight for all the infrastructure awards in the joint TDHCA and ORCA Disaster Recovery Application and at the application workshops. Specifically, the joint TDHCA and ORCA "Special Application Guide – Rita Disaster Recovery Funds – CDBG Disaster Recovery Funds to Aid Areas Most Impacted and Distressed by Hurricane Rita, May 2006" provided that: "Evidence of sufficient financial oversight as established by an "Independent Auditor's Report" from the applicant's 2004, or if available, 2005 audited financial statements must be submitted if required by active contract requirements, previously administered by the applicant." This statement was intended to clarify and further interpret the action plan regarding the timeframe and process for submitting the required evidence of financial oversight. The agency implemented this process by including the standard CDBG financial oversight provision in the contract with each subrecipient.

In addition, as the report documents, the agency had an established relationship with most of the city and county subrecipients that included reviewing their financial oversight processes over a number of years. As part of the disaster recovery contract awarding process, the agency's Audit staff submitted to program management its audit review of all those subrecipients that had an established relationship with the agency. Further, the agency used a management signoff form prior to executing

the contract to determine whether agency staff members were aware of any issues for the subrecipient involving project management, audit or monitoring reports.

No timeline for implementing changes is required because the action plan only covered the first round of disaster recovery funds and all contracts have been awarded. The action plan covering the second round of disaster recovery funding removed the provision being addressed in this response.

Chapter 2-B

The Office of Rural Community Affairs Should Strengthen Certain Controls Over Its Awards of Rural Health Disaster Relief and Recovery Grant Funds to Prevent Noncompliance with Requirements that Help to Deter Fraud, Waste, and Abuse

Eligible Uses for Rural Health Disaster Relief and Recovery Funds

Eligible uses for Rural Health Disaster Relief and Recovery Grant funds include the following:

- Emergency acquisition, construction, repair or improvement of facility or equipment.
- Pharmaceuticals and medical supplies.
- Infection control supplies.
- First aid and life-saving equipment and supplies for first-response situations.
- Emergency capital, electronic, or communication equipment.

The Office of Rural Community Affairs generally administers Rural Health Disaster Relief and Recovery Grant funds in accordance with program requirements. However, it should strengthen controls over the award of these funds.

Rural Health Disaster Relief and Recovery Grant funds assist rural hospitals and rural health clinics to respond to federal or state disaster declarations (see text box for additional details). When awarding these funds, the Office of Rural Community Affairs gave priority to applicants who needed immediate relief from Hurricane Katrina or Hurricane Rita and who were located in eligible counties.

The Office of Rural Community Affairs should retain documentation of its verification of recipient eligibility.

The Office of Rural Community Affairs did not retain the documentation it used to verify the eligibility of recipients of Rural Health and Disaster Relief and Recovery Grant funds. Examples of this documentation could include proof that the recipient served a medically underutilized area and that it served an area with a population of fewer than 150,000 people.

Auditors tested a sample of recipients of these funds and verified that they met eligibility requirements. However, by not retaining its verification documentation, the Office of Rural Community Affairs risks having its awards of these funds challenged.

Recommendation

The Office of Rural Community Affairs should retain documentation it uses to verify recipients' eligibility for Rural Health Disaster Relief and Recovery Grant funds.

Management's Response

In the case of retaining documentation to verify recipient's eligibility for Rural Health Disaster Relief and Recovery Grant funds, the question of eligibility referred to whether the awardee resided in a rural area as defined by the program. SORH Division staff verifies the rural status by confirming the grantee is located in a rural area according to the Department of State Health Services website. In order to better document this process, beginning immediately with the current application cycles, a statement will be included on the application checklist for the staff person to check when verification is made. Documentation will include the signature and date the staff person verified rural status. The Director of the State Office of Rural Health Division will be responsible for implementing the corrective action.

Chapter 2-C

The Office of Rural Community Affairs Should Strengthen Certain Controls Over Its Awards of Public Shelter Improvement Program Funds to Prevent Noncompliance with Requirements that Help to Deter Fraud, Waste, and Abuse

The Office of Rural Community Affairs generally administers Public Shelter Improvement Program funds in accordance with program requirements.

However, it did not maintain documentation that it verified that subrecipients of these funds were not suspended or debarred from entering into contracts. Title 24, Code of Federal Regulations, Part 24, specifies that entities that are debarred, suspended, or otherwise excluded from or ineligible for federal assistance programs cannot participate in federally funded transactions. By not maintaining this documentation, the Office of Rural Community Affairs risks contracting with ineligible subrecipients.

The Office of Rural Community Affairs entered into contracts with communities for \$430,000 of the \$1 million available from Public Shelter Improvement Program Funds. It subsequently stopped awarding contracts through this program when the State received the first round of Community Development Block Grant funds.

Source and Eligible Uses for Public Shelter Improvement Program Funds

The Office of Rural Community Affairs established this fund to assist communities affected by Hurricanes Katrina and Rita. It used \$1 million in deobligated Community Development Block Grant funds and Community Development program income for this fund.

Eligible activities for these funds include shelter improvements and renovations to address emergency shelter needs related to Hurricane Katrina and Hurricane Rita. Examples include water and wastewater improvements; plumbing; restroom facilities; and electrical, communication, and heating and air conditioning systems.

Recommendation

The Office of Rural Community Affairs should document its verification that subrecipients of Public Shelter Improvement Program Funds are not suspended or debarred from contracting before it awards contracts.

Management's Response

As documented in the report, the Office of Rural Community Affairs has included certification language in all new contracts that would satisfy the requirement for verifying a city, county, or federally-recognized tribe is not suspended or debarred. While the agency has adjusted the process to include the necessary certification in its standard CDBG contract, it also recognizes that it is highly unlikely that a city or county government would have been suspended or debarred and therefore the potential risk was quite minimal. In addition, we note that the agency has always verified and confirmed that construction contractors who work on the CDBG projects, including these disaster recovery projects, have not been suspended or debarred.

Chapter 2-D

The Office of Rural Community Affairs Should Conduct Regular Reconciliations of the Financial Information in Its Systems

The Office of Rural Community Affairs does not reconcile award information for the Community Development Block Grant program, the Rural Health Disaster Relief and Recovery Grant program, and the Public Shelter Improvement Program in its accounting system to information in its grants management system. The Office of Rural Community Affairs considered this process to be a low priority because the accounting system and grants management system interface; therefore, it did not develop policies or procedures to perform this reconciliation.

While the Office of Rural Community Affairs does not perform this reconciliation, it verifies contract balances, expended amounts, and remaining balances as part of its process to draw down federal funds. This helps to mitigate risks associated with not reconciling its accounting system and grants management system. However, not reconciling these systems increases the risk that data the Office of Rural Community Affairs uses for reporting and contract management may be incorrect.

The Office of Rural Community Affairs reconciled its accounting system to the Uniform Statewide Accounting System. However, it did not always perform these reconciliations in a timely manner. Three of four reconciliations tested were prepared and reviewed by Office of Rural Community Affairs management on July 2, 2007, during the course of this audit. These

reconciliations were performed from one to more than four months following the end of the activity period. The Office of Rural Community Affairs' policies and procedures state that reconciliations must be performed on a timely basis and must be performed at least every quarter. However, the Office of Rural Community Affairs experienced turnover among its staff and fell behind in completing these reconciliations. If systems are not reconciled on a timely basis, inaccuracies in the Office of Rural Community Affairs' financial accounting system or USAS may go undetected, which creates an opportunity for fraud, waste, or abuse of funds.

Recommendations

The Office of Rural Community Affairs should:

- Reconcile information in its accounting system to information in its grants management system on a regular basis.
- Reconcile its accounting system with USAS in a timely manner and ensure that all variances between the two systems are researched, documented, and corrected.

Management's Response

- *As indicated in Chapter 2-D above, the Office of Rural Community Affairs interfaces USAS payment data from its MIP Financial System to its Grant Contracts Management System. Financial staff verifies contract balances, expended amounts and remaining balances as part of the grant draw process. While these business processes provide reasonable assurance that grant contract balances are in agreement, we do agree that an ongoing reconciliation process between the MIP Financial System and the Grant Contracts Management System is a prudent business process to implement.*

The Finance Division Team Lead will work with Community Development and Rural Health division staff to implement the necessary business processes and procedures to ensure the MIP Financial System and the Grant Contracts Management System are reconciled. This responsibility will be shared by the Finance Division, which is responsible for financial reconciliations and MIP Financial System data, and the Community Development and Rural Health Divisions, which are responsible for the Grant Contracts Management System data. This project will be implemented during the 2008 fiscal year.

- *We agree that a reconciliation of USAS to our MIP Financial System should be completed timely. As indicated in Chapter 2-D above, the*

unexpected departure of our senior General Ledger Accountant caused the Finance Division to temporarily fall behind schedule on completing the USAS-to-MIP Financial System reconciliations. As soon as a new General Ledger Accountant was hired, the outstanding reconciliations were caught up and they have been completed on time ever since.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to determine whether the Department of Housing and Community Affairs and the Office of Rural Community Affairs appropriately awarded and disbursed hurricane recovery funds. Specific objectives were to:

- Determine whether hurricane recovery funds were awarded based on award criteria and requirements.
- Determine whether hurricane relief funds were disbursed in a timely manner.

Scope

The audit scope covered all matters related to the administration of the two awards of Community Development Block Grant funds for hurricane recovery, as well as funds from other sources administered after September 1, 2005. The audit scope also included the automated systems and processes that support the functions being audited; however, audit work related to automated systems was limited to determining the reliability of the information in automated systems.

Methodology

The audit methodology included collecting information and conducting interviews with staff at the Department of Housing and Community Affairs, Office of Rural Community Affairs, councils of governments, selected contract recipients, and selected contract administrators; performing selected tests and procedures; and analyzing and evaluating the results of the tests.

Information collected and reviewed included the following:

- *State of Texas Action Plan for Community Development Block Grant Disaster Recovery Grantees under the Department of Defense Appropriations Act, 2006; April 13, 2006* (prepared jointly by the Department of Housing and Community Affairs and the Office of Rural Community Affairs).
- *Proposed Partial Action Plan for Disaster Recovery to Use Community Development Block Grant Funding to Assist with the Recovery of*

Distressed Areas Related to the Consequences of Hurricanes Katrina, Rita, and Wilma in the Gulf of Mexico in 2005; April 13, 2007 (prepared by the Department of Housing and Community Affairs).

- *Partial Action Plan* jointly prepared by the City of Houston and Harris County as an amendment to the *State of Texas Partial Action Plan for Disaster Recovery to Use Community Development Block Grant funding to Assist with the Recovery of Distressed Areas Related to the Consequences of Hurricanes Katrina, Rita, and Wilma in the Gulf of Mexico in 2005*.
- Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of governments' policies and procedures.
- Interviews with staff from the Department of Housing and Community Affairs, the Office of Rural Community Affairs, the councils of governments, and contract administrators.
- Data from automated systems at the Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of governments, including the financial accounting and contract management systems.
- Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of governments documents including organizational charts, program implementation manuals, application files, expenditure files, funding allocation methodologies, procurement documents, and grant funding announcements and applications.
- Review of literature relating to hurricane recovery programs and administration, including news articles and information from the U.S. Department of Housing and Urban Development.

Procedures and tests conducted included the following:

- Analysis of data from the financial accounting systems of the Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of governments.
- Analysis of information from the councils of governments' application management systems.
- Testing of selected Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of government housing and non-housing grant application files to ensure consistency and compliance with federal and state rules, program requirements, and policies and procedures.

- Testing of selected Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of governments' expenditure files to ensure consistency and compliance with federal and state rules, program requirements, and policies and procedures.
- Analysis of data from the Uniform Statewide Accounting System.
- Review of councils of governments' organizational charts to determine staff-to-applicant ratios for the Community Development Block Grant program.
- Analysis of councils of governments' allocation methodologies for the Community Development Block Grant non-housing assistance funding to ensure compliance with federal and state rules, program requirements, and policies and procedures.
- Analysis of councils of governments' procurements of goods and services from manufactured housing providers, construction managers, and contractors to ensure consistency and compliance with program requirements and policies and procedures.
- Analysis of contracts between the Department of Housing and Community Affairs and the Office of Rural Community Affairs; the Department of Housing and Community Affairs and the councils of governments; and the Office of Rural Community Affairs and the councils of governments.
- Review of monitoring procedures and monitoring reports.

Criteria used included the following:

- Code of Federal Regulations.
- Texas statutes and the Texas Administrative Code.
- U.S. Office of Budget and Management circulars.
- Department of Housing and Community Affairs, Office of Rural Community Affairs, and councils of governments' policies and procedures.
- Housing and Community Development Act of 1974.
- Contract provisions.
- Public Laws 109-135, 109-148, and 109-234.
- U.S. Code.

Project Information

Audit fieldwork was conducted from August 2007 through September 2007. This audit was conducted in accordance with generally accepted government auditing standards.

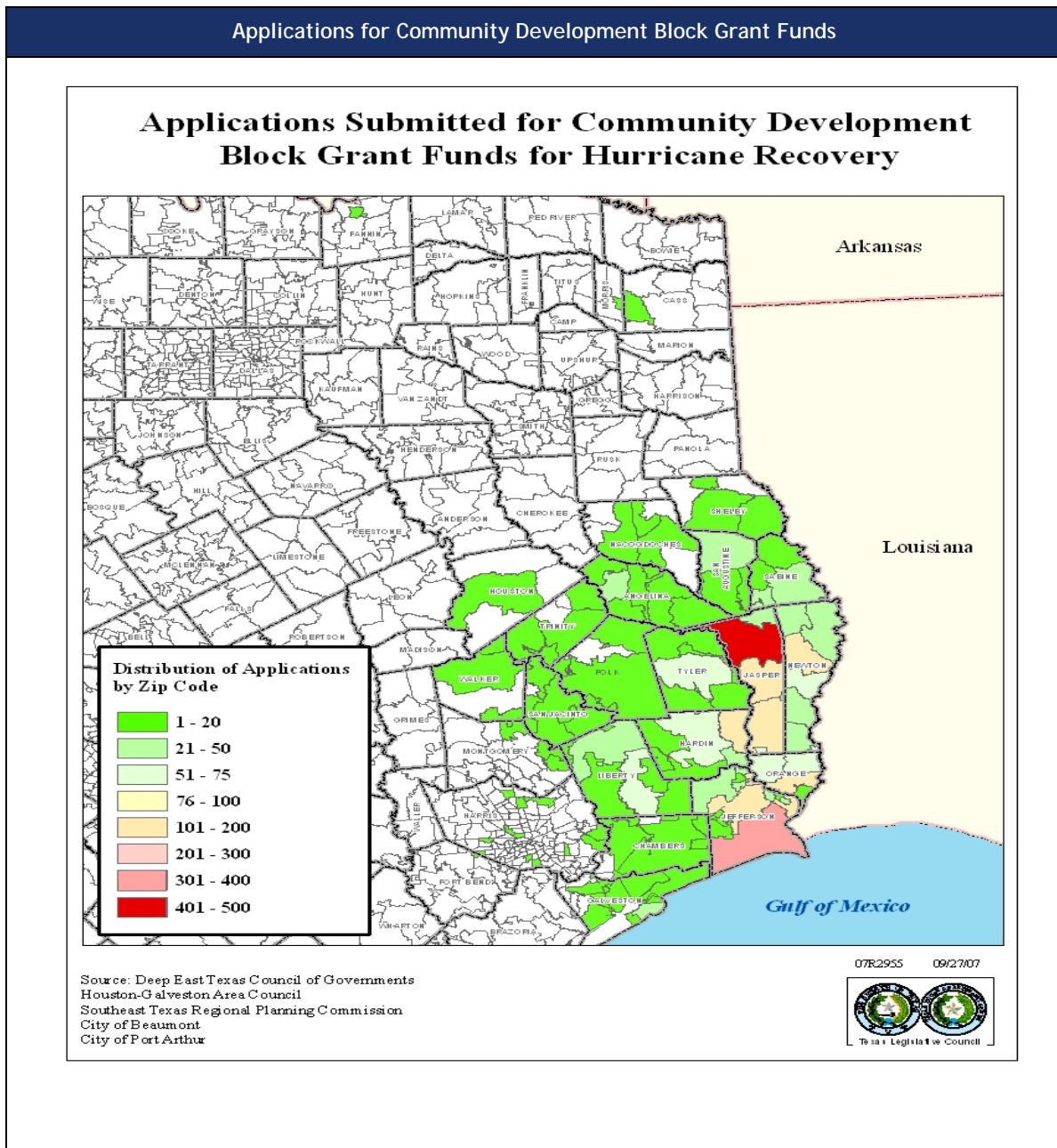
The following members of the State Auditor's staff performed the audit:

- James Timberlake, CIA (Project Manager)
- Jennifer Lehman, MBA, CGAP (Assistant Project Manager)
- Amadou Ngaide, CFE, MBA
- Lisa Thompson
- Brian York
- Gary Leach, MBA, CQA, CISA (Information Systems Audit Team)
- Leslie Ashton, CPA (Quality Control Reviewer)
- Walton Persons, CPA (Quality Control Reviewer)
- Worth S. Ferguson, CPA (Quality Control Reviewer)
- Michael Apperley, CPA (Audit Manager/Assistant State Auditor)

Distribution of Applications for Community Development Block Grant Funds

Figure 1, created through coordination with the Texas Legislative Council, shows the distribution of applications for Community Development Block Grant funds for hurricane recovery.

Figure 1



Department of Housing and Community Affairs' Overall Management Responses

Thank you for the opportunity to respond to the State Auditor's Office audit report on hurricane recovery funds. We generally agree with the recommendations in the report and plan to implement them. We appreciate the efforts of your staff in conducting this in-depth review.

We are continuing to work diligently to move the disaster recovery program forward. As of today, 4,130 applicants have applied to the program, 193 households have been determined to meet all eligibility criteria, 62 homes are under construction, and 29 homes have been placed on the ground. We anticipate that only 539 households will be served with the funding available through the first funding round; the balance of applicants will become part of the applicant pool for the second round of funding. The partnership that has developed between the Department and the Councils of Governments is continuing to move the program forward and our collaborative efforts are addressing impediments to a very challenging federally funded program. Lessons learned over the past year and a half will be applied where applicable to the second supplemental round of funding received by the State.

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Warren Chisum, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Department of Housing and Community Affairs Board

Ms. Elizabeth Anderson, Chair
Mr. C. Kent Conine, Vice Chair
Mr. Shadrick Bogany
Mr. Dionicio Vidal (Sonny) Flores
Ms. Gloria L. Ray
Mr. Norberto Salinas

Department of Housing and Community Affairs

Mr. Michael Gerber, Executive Director

Office of Rural Community Affairs Executive Committee

Mr. Michael Cooper Waters, Chair
Mr. David Richey Alders, Vice Chair
Ms. Nicki Harle, Secretary
Mr. Charles N. Butts
Ms. Carol Harrell
Mr. Wallace Klussmann
Ms. Lydia Rangle Saenz
Mr. Ike Sugg
Mr. Patrick Wallace

Office of Rural Community Affairs

Mr. Charles S. Stone, Executive Director



This document is not copyrighted. Readers may make additional copies of this report as needed. In addition, most State Auditor's Office reports may be downloaded from our Web site: www.sao.state.tx.us.

In compliance with the Americans with Disabilities Act, this document may also be requested in alternative formats. To do so, contact our report request line at (512) 936-9880 (Voice), (512) 936-9400 (FAX), 1-800-RELAY-TX (TDD), or visit the Robert E. Johnson Building, 1501 North Congress Avenue, Suite 4.224, Austin, Texas 78701.

The State Auditor's Office is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, national origin, age, or disability in employment or in the provision of services, programs, or activities.

To report waste, fraud, or abuse in state government call the SAO Hotline: 1-800-TX-AUDIT.