

An Audit Report on

The Housing Trust Fund and HOME Investment Partnerships Programs at the Department of Housing and Community Affairs

July 2005

Report No. 05-047



**State
Auditor's
Office**

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State Auditor

The Housing Trust Fund and HOME Investment Partnerships Programs at the Department of Housing and Community Affairs

Overall Conclusion

The Department of Housing and Community Affairs (Department) cannot ensure that it allocates funds from the HOME Investment Partnerships (HOME) and Housing Trust Fund programs to the parts of the State with the highest need. Specifically, in fiscal year 2004, the regional allocation formulas that the Department used to allocate funds from these programs did not contain all statutorily required information. Additionally, the Department may not be obtaining information necessary to identify regional housing needs because it did not comply with statutory requirements regarding its coordination with regional development coordinators across the state.

The Department awarded HOME funds in accordance with federal requirements. It awarded funds from the Housing Trust Fund in accordance with state requirements, but it should work to increase the number of qualified applicants for that program. In fiscal year 2004, the Department did not award approximately \$839,000 of the \$5.4 million in funds available from the Housing Trust Fund program. (In addition to the \$5.4 million in available funds from the Housing Trust Fund, the Department also was permitted to carry forward \$5.8 million in funds from the Housing Trust Fund that it had awarded in the prior fiscal year but had not yet spent.)

According to the Department, it did not receive enough qualified applicants to be able to award more funds from the Housing Trust Fund. The General Appropriations Act (78th Legislature) established a performance measure for the Department to serve 1,686 households through the Housing Trust Fund program in fiscal year 2004. According to the Department's 2005 *State of Texas Low Income Housing Plan and Annual Report*, the Department served 325 households in fiscal year 2004 through the Housing Trust Fund program.

Background Information

The HOME program provides grants and loans to help local governments, nonprofit agencies, and public housing agencies provide safe, decent, affordable housing to extremely low-, very low-, and low-income families. HOME allocates funds through four activities: homebuyer assistance, rental housing development, owner-occupied housing assistance, and tenant-based rental assistance. In fiscal year 2004, the HOME program received approximately \$49.5 million in federal funding.

The Housing Trust Fund is a state program that awards funds for the acquisition, rehabilitation, and new construction of affordable housing. These funds are awarded to nonprofit and for-profit organizations, local governments, public housing authorities, community housing development organizations, and income-eligible individuals and families. In fiscal year 2004, \$5.4 million in funds from the Housing Trust Fund were available.



Although the Department's contract award process for the HOME and Housing Trust Fund programs is generally objective, noncompliance with certain application scoring requirements diminishes the Department's objectivity in awarding contracts.

The Department's monitoring procedures generally ensure compliance with certain HOME and Housing Trust Fund program requirements. However, the Department should make improvements to its monitoring risk assessment process for the HOME program. Specifically, the Department does not have documented procedures to determine the weights applied to the risk assessment for this program.

Summary of Management's Response

With one exception, the Department generally agrees with our findings and recommendations. In Chapter 3, we have provided an auditor's follow-up comment regarding the finding with which the Department disagrees.

Summary of Information Technology Review

Our review of information technology focused on the Department's automated contract system. The contract system is used to process HOME contracts and track grant funding. In addition, we reviewed the process by which the Department reconciles information in its contract system, the U.S. Department of Housing and Urban Development's Integrated Disbursement and Information System (IDIS, the system from which the Department draws down federal funds), and the Department's accounting system.

Automated controls in the Department's processing of HOME contracts are sufficient. However, we noted a data integrity issue within the Department's contract system that the Department should correct. In addition, while most personnel involved in the HOME contracting process have proper access to the transaction process, four users have the ability to both request and approve federal funds drawdowns from IDIS.

Summary of Objectives, Scope, and Methodology

Our objectives were to:

- For the HOME and Housing Trust Fund programs, determine whether the Department (1) has a process to deliver housing services to the neediest parts of the state, (2) objectively awards contracts, (3) effectively monitors contracts, and (4) ensures that funds are disbursed in a timely manner.
- Determine whether the Department has used appropriations for the HOME and Housing Trust Fund programs in accordance with limitations and directions

imposed by federal law, state law, or Department policy, including riders in the General Appropriations Act affecting these programs.

Our scope covered the HOME and Housing Trust Fund programs during fiscal years 2000 through 2004. We audited monitoring processes, contract awards, and compliance with appropriation riders related to fiscal years 2003-2004. Our audit of the Department's housing needs assessment and awards process covered fiscal years 2000 through 2004.

The audit methodology included conducting interviews with program staff, performing detailed test work, and analyzing agency data.

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Detailed Results

Chapter 1

The Department Cannot Ensure that It Allocates HOME and Housing Trust Fund Program Funds to the Parts of the State with the Highest Need

The Department of Housing and Community Affairs (Department) cannot ensure that it allocates HOME Investment Partnerships (HOME) and Housing Trust Fund (HTF) program funds to the parts of the state with the highest need in accordance with the statute because:

- In fiscal year 2004, the regional allocation formulas the Department used to allocate funds from these programs did not contain all statutorily required information.
- The Department may not be obtaining information necessary to identify regional housing needs because it did not comply with statutory requirements regarding its coordination with regional development coordinators across the state.

This noncompliance could impair the Department's ability to ensure that it consistently targets funds as required.

The Department generally complied with other state and federal requirements when awarding funds from and administering the HOME and Housing Trust Fund programs.

Chapter 1-A

The Department's Regional Allocation Formulas Did Not Contain All Statutorily Required Information to Allocate Funds for the HOME and Housing Trust Fund Programs

Regional Allocation Formulas

Section 2306.111(d) of the Texas Government Code requires the Department to allocate HOME, Housing Trust Fund, and Housing Tax Credit program funding through regional allocation formulas. The formulas are based on the need for housing assistance and the availability of housing resources in urban/exurban areas and rural areas.

While the Department used the regional allocation formulas to award funds, the formulas did not consider all information required by statute (see text box for a description of the regional allocation formulas). Specifically:

- In fiscal year 2004, the Department's regional allocation formulas did not consider a portion of the funds disbursed through its Housing Tax Credit program. Texas Government Code, Section 2306.111(d), requires the regional allocation formulas for the HOME and Housing

Trust Fund programs to consider other available housing resources in the regions. As a result, the Department may have overallocated funding to some regions that received funds from other sources. Therefore, it is

possible that areas with the highest need for state resources did not receive the appropriate amount of funding.

- The Department was unable to demonstrate in its needs assessment process that it considered input from statutorily required groups and/or the regional development coordinators when it prepared its *State of Texas Low Income Housing Plan and Annual Report* (see Chapter 1-B for additional issues related to regional development coordinators). Texas Government Code, Section 2306.111(d), requires the Department to “use the information contained in its annual state low income housing plan and shall use other appropriate data to develop the formula” for the HOME and Housing Trust Fund programs. Because the Department was unable to demonstrate that it considered input from the regional development coordinators in its *State of Texas Low Income Housing Plan and Annual Report*, not all of the required information was present in the regional allocation formula. Without consideration of the input and data from the regional development coordinators, the Department may not be meeting housing needs across the state. Department management indicated that the Department has attempted to obtain this data from the regions but has been unable to get an adequate response.

Recommendations

The Department should:

- Consider other available housing resources in the regions when developing the regional allocation formulas.
- Incorporate input from regional development coordinators in its regional allocation formulas as required by statute.

Management’s Responses

- *Recommendation – The Department should consider other available housing resources in the regions when developing the regional allocation formulas.*

Management’s Response:

The Department began including HOME, Housing Trust Fund (HTF) and Housing Tax Credits (HTC) as sources of other available housing resources in the 2005 Regional Allocation Formula (RAF) as a way of addressing variances between the funds actually allocated and the RAF. These variances resulted primarily from set-aside and geographical area (urban/exurban and rural) requirements.

While the Department recognizes that HOME, HTF, and HTC were not used as sources of available housing resources in prior years' RAFs, their exclusion was by design and with opportunities for full public input. When the RAF was originally developed, the Department concluded it seemed illogical to include the Department's HOME, HTF, and HTC funding as available housing resources in the same formula that distributes these funds regionally. The reasoning was that if the RAF was an objective way to distribute those funds, then those funds by default would be equitably distributed to each of the regions. In effect, their inclusion in the formula would diminish the impact that considering available resources that are not controlled directly by the RAF would have on the regional funding distribution.

When the formula was originally developed in 2001, dividing the HOME, HTC, and HTF funding into separate urban/exurban and rural allocation targets (in addition to existing programmatic set-asides) within each region was not legislatively required. With the additional geographical area targeting required by SB 264 of the 78th Legislature, 26 separate allocation targets were created. As a result, the actual award allocation is more likely to vary from the RAF's targeted allocation. This is because the highest scoring applications, each with specific award requests, will not exactly align with the 13 regional and 26 intra-regional allocation targets. To address any resulting regional allocation variances, the HOME, HTC, and HTF allocation amounts were added to the "available resources" considered in the 2005 RAF.

Each year, including the years that did not include HOME, HTF and HTC as available housing resources, the formula was submitted for public comment with a clear description of the funding being considered. A summary of the RAF approved by the Department's Governing Board was published in the State Low Income Housing Plan and Annual Report (SLIHP), which was provided to the governor, lieutenant governor, speaker of the house of representatives, and members of the Department's legislative oversight committee. No comments were received regarding whether Department funds should or should not be included in the formula.

Responsible Employee: Director of Policy and Public Affairs

Timeline for Implementation/Implementation Date: Complete

- *Recommendation – The Department should incorporate input from regional development coordinators in its regional allocation formulas as required by statute.*

Management Response:

The Department has incorporated input from the regional development coordinators (RDCs) in its ongoing development of the RAF. As discussed in more detail in its response to the SAO audit's Chapter 1-B findings, the legislatively unfunded RDC initiative has been addressed to the extent possible by the Department. The summary reports of the Council of Governments' (COG) representatives, who function as the RDC in their respective regions, on the Regional Advisory Committee (RAC) meetings are analyzed and reported on in great detail by the Department in the annual Report on the Regional Advisory Committee Meetings on Affordable Housing and Community Services Issues. Summary information from this report is included in the SLIHP.

The Department believes that the purpose of the RAF is to ensure that the subject funds are allocated using uniform and objective measures of need such as US Census need data and available resource need data collected directly from the various state and federal sources is consistent with statute. Public comment affects the way this information is used in the formula. For example, public comment affects the RAF by helping determine: what U.S. Census data is used to measure need; how this data is weighted in terms of relative importance; geographical area definitions; and what types of funding is used to measure available housing resources. The comment that affects the RAF is collected and considered in the process of developing the SLIHP. Sources of this comment include public hearings, written comment, round table program development meetings, and RAC meetings.

The Department conducts an enormous amount of public outreach to ensure that its programs are responsive to needs identified through this process. This outreach helps form the policy and rules that are formally established in the SLIHP. Section 2306.072(a) and § 2306.072 provide very specific instructions on how public participation should be built into the SLIHP's development process. Within each SLIHP, a detailed description of how these public involvement requirements are met is provided. A few specific examples are provided below:

- *Public hearings that involve the participation of Department staff from a variety of program areas, including HOME, HTF, and HTC were held annually in each of the 13 state service regions to gather comment that affects the development of the final SLIHP. Detailed reasoned responses to comments provided at these hearings and in writing during the public comment period on the RAF are provided in the SLIHP.*
- *"Round table" meetings were held to discuss the upcoming year's HOME and HTC activities. At these meetings a variety of topics,*

including the RAF, were discussed by a diverse group of interested parties which included councils of government and developers.

- *RAC meetings were held in those regions where the COGs, responsible for forming the committees, formed the committees. The RAC meetings were held in advance of developing and publishing the proposed SLIHP. Observations from these meetings were considered as part of the development process for the SLIHP.*

Responsible Employee: Director of Policy and Public Affairs

Timeline for Implementation/Implementation Date: Complete

Chapter 1-B

The Department Did Not Comply with Requirements Regarding Its Coordination with Regional Development Coordinators Across the State

The Department did not always comply with statutory requirements regarding its coordination with regional development coordinators (see text box for a

Regional Development Coordinators

Section 2306.079 of the Texas Government Code requires the Department to employ or contract with a regional development coordinator for each uniform state service region of this state.

Examples of the regional development coordinators' responsibilities include:

- Assisting local communities in determining how to address affordable housing and community development needs
- Establishing regional planning and resource-sharing partnerships
- Facilitating the leveraging of available local, state, and federal funds

The Department has entered into memorandums of understanding with councils of government for them to provide the staff to perform these responsibilities.

description of regional development coordinators). Because of this, regional development coordinators are interpreting and carrying out requirements in different ways, and the Department may not be obtaining information necessary to identify regional housing needs. As a result, the Department may not be meeting housing needs across the state.

Examples of noncompliance include the following:

- In fiscal year 2004, the Department did not employ or contract with a regional development coordinator for each uniform service region of the state as required by Texas Government Code, Section 2306.079. Of the 13 designated regions throughout the state, 11 had an individual identified as a regional development

coordinator. Because the Department is not fully complying with this statute, it is not providing the required services to the two regions without regional development coordinators or obtaining and considering the information needed to correctly assess the needs within each of these regions.

- The Department's 2004 guidelines for regional development coordinators did not align with statutory requirements. For example, the Department's guidelines did not specify that the primary responsibilities of the regional development coordinators are to (1) assist local communities in determining how to address affordable housing and community

development needs; (2) establish regional planning and resource-sharing partnerships; and (3) facilitate the leveraging of available local, state, and federal funds. Each of those responsibilities is required by Texas Government Code, Section 2306.079(b). Because the Department's guidelines do not align with statutory requirements, the regional development coordinators are not providing the Department or the regions with the information needed to correctly assess needs. Further, the regional development coordinators are unaware of their statutorily required responsibilities.

- The Department's 2004 guidelines also did not require regional development coordinators to gather and manage data related to affordable housing and community development needs from specific data sources (such as the U.S. Census Bureau, the U.S. Department of Housing and Urban Development, and the Texas State Data Center) as required by Texas Government Code, Section 2306.079(c). Additionally, the

Regional Advisory Committees

In each uniform state service region, the regional planning commission and other regional partners are required to establish an advisory committee consisting of representatives of two or more "regional partners." A regional partner must be an entity that is engaged in data-gathering projects related to the goals of the Department.

A regional partner can be a regional planning commission, political subdivision, local nonprofit organization, institution of higher education, community housing development organization, housing finance corporation, public housing authority, agricultural extension agent, local bank, or field office or service center of a U.S. Department of Agriculture Rural Development Office.

guidelines did not require regional development coordinators to identify partners for the Department to team with in order to provide housing to the needy (for example, by identifying programs that leverage local, state, and federal financial aid) as required. As a result, the Department does not have the necessary information to allocate funding to the neediest areas of the state.

In our discussions with 5 of the 11 regional development coordinators, we also were informed that regional advisory committees do not always comprise the representatives required by statute (see text box for

additional information regarding these committees). The Texas Government Code, Section 2306.079(d), requires that representatives of two or more regional partners establish a regional advisory committee. A list of attendees at these committee meetings that the Department provided indicated that these representatives were not present at meetings for 3 of the 13 regions. As a result, the regional development coordinators may not be obtaining from the regional advisory committees the information that is necessary to correctly assess housing needs.

Recommendations

The Department should:

- Ensure that it employs or contracts with a regional development coordinator for each uniform service region of the state as required by statute.

- Develop guidelines for the regional development coordinators that align with statutory requirements.
- Ensure that the regional advisory committees comprise the representatives required by statute.

Management's Responses

- *Recommendation – The Department should (1) ensure that it employs or contracts with a regional development coordinator of each uniform service region of the state as required by statute.*

Management's Response:

The Department executed Memorandums of Understanding with COGs to address the legislative requirements of the RDCs. For the first year, part time RDCs were funded through the use of bond proceeds; however, it should be noted that even with this limited funding, the ability to meet the legislative requirements, which were not funded, was severely limited.

After the first year, resources were not available for the Department to continue funding the 13 part-time RDC positions. From that point forward, due to the COGs' own staff and financial constraints, their level of participation in the RDC process was limited to facilitating the RACs. The Department staff continued to provide extensive support with mass mailings, website support, meeting development, and report compilation.

While this mandate was not funded, the Department pursued the goals of the legislation in good faith. The Department also believes its good faith efforts extend beyond what might be expected considering Section 10.90 of the Department's "Contingency Rider", General Appropriations Act, Seventy-seventh Legislature, Reg. Sess., which reads as follows:

It is the intent of the Legislature that: Appropriations made in this Act be expended only for purposes and programs specifically funded in the Act, and contingency appropriations made for legislation adopted by the Seventy-seventh Legislature be the sole source of funding for implementation of that legislation. No state agency or institution of higher education is required to reallocate or redistribute funds appropriated in this Act to provide funding for programs or legislation adopted by the Seventy-seventh Legislature for which there is not specific appropriation or contingency provision identified in this Act.

The RDC initiative is an unfunded mandate since neither Full-Time Equivalent staff (FTEs) nor specific appropriations were designated for this initiative in the Department's bill pattern through the General Appropriations Act. However, the Department will continue to work in concert with the COGs to gather regional input on how available housing resources can be most effectively used to address the affordable housing needs of each region. As funding is not available at this time, the Department is unable to "employ or contract with a regional development coordinator for each uniform state service region of this state."

Responsible Employee: Director of Policy and Public Affairs

Timeline for Implementation/Implementation Date: Complete

- *Recommendation – The Department should develop guidelines for the regional development coordinators that align with statutory requirements.*

Management Response:

As described in the response to the previous recommendation, as funding is not available at this time, regional development coordinators will not be available to address the duties outlined in statute.

Responsible Employee: Director of Policy and Public Affairs

Timeline for Implementation/Implementation Date: Complete

- *Recommendation – The Department should ensure that the regional advisory committees comprise the representatives required by statute.*

Management Response:

The Department does not have the authority to ensure RACs comprise the representatives required by statute. According to Government Code 2306.079(d), it is the COGs that are to form the RACs. The Code states, in part, "... the regional planning commission and other regional partners shall establish an advisory committee consisting of representatives of two or more regional partners."

For those COGs that choose to hold RACs, the Department can continue its substantial efforts to provide administrative support and planning assistance. The Department believes that representatives required by statute were present at the RAC meetings where the COGs, responsible for forming the committees, formed the committees.

Responsible Employee: Director of Policy and Public Affairs

Timeline for Implementation/Implementation Date: Complete

The Department Generally Complied with Other State and Federal Requirements When Awarding Funds from and Administering the HOME Program and the Housing Trust Fund

The Department complied with nearly all other state and federal requirements when awarding funds and administering the HOME and Housing Trust Fund programs. In a sample of eight HOME applications and two Housing Trust Fund applications, we did not find any instances of noncompliance with the requirements regarding contract close-out procedures, income eligibility, lead paint hazard, environmental clearance, rent limitation, or the affirmative fair housing marketing plan.

The Department complied with a requirement in Rider 3, page VII-1, of the General Appropriations Act (78th Legislature) to submit quarterly reports to the Legislative Budget Board (see Appendix 2 for Rider 3). However, for the HOME program, the Department could not provide supporting documentation for the number of households served by income level that was specified in those reports.

Recommendations

The Department should maintain documentation to support the information provided to the Legislative Budget Board regarding the number of households served by income level.

Management's Responses

The Department does maintain documentation to support the information it provides to the Legislative Budget Board regarding the number of households served by income level. However, staff acknowledges that it made errors in compiling summary information supported by the documentation and has improved its controls over the reporting process to preclude similar errors in the future.

Responsible Employee: Director of Policy and Public Affairs

Timeline for Implementation/Implementation Date: Complete

The Department Awarded HOME Funds in Accordance with Federal Requirements; It Awarded Funds from the Housing Trust Fund in Accordance with State Requirements but Should Work to Increase the Number of Qualified Applicants for That Program

The Department awarded HOME funds in accordance with federal requirements.

According to the Department:

- In fiscal year 2004, the Department received \$49.5 million in HOME funds from the U.S. Department of Housing and Urban Development (HUD).
- As of March 2005, the Department had committed \$19 million (42.56 percent) of that amount. HUD requires that HOME funds be committed within 24 months.

The Department awarded funds from the Housing Trust Fund in accordance with state requirements, but it should work to increase the number of qualified applicants.

As Table 1 shows, according to Department information, the Department had a total of \$5.4 million in available funding from the Housing Trust Fund in fiscal year 2004.

Table 1

Funds Available from the Housing Trust Fund for Fiscal Year 2004	
State appropriations	\$ 3.25 million ^a
Deobligations from the prior year	1.05 million
Program income	1.10 million
Total funds available	\$ 5.40 million
^a The \$3.25 million amount did not include \$5.8 million in funds from the Housing Trust Fund that the Department had awarded in the prior fiscal year but had not yet spent. Rider 15 of the General Appropriations Act (78th Legislature) permitted the Department to carry forward funds that were awarded but not yet spent. Source: Unaudited information from the General Appropriations Act and the Department	

Of the \$5.4 million in available funds, according to the Department, it:

- Awarded \$3 million through the Texas Bootstrap Loan Program.
- Used approximately \$440,000 to cover administrative costs.
- Awarded approximately \$1,120,509 in new contracts.

This left approximately \$839,000 in funds that were not awarded. According to the Department, it did not receive enough qualified applicants to be able to award more funds from the Housing Trust Fund. The General Appropriations Act established a performance measure for the Department to serve 1,686 households through the Housing Trust Fund program in fiscal year 2004. According to the Department's 2005 *State of Texas Low Income Housing Plan and Annual Report*, the Department served 325 households in fiscal year 2004 through the Housing Trust Fund program.

Recommendations

The Department should work to increase the number of qualified applicants for the Housing Trust Fund program so that it can award all available funds.

Management's Responses

Staff agrees that the Department needs to work more diligently to increase the number of qualified applicants for the Housing Trust Fund. The Department has worked closely with the nonprofit and for profit development community, local governments and housing advocates towards this goal.

However, the Department wishes to highlight that the primary limitation to the Housing Trust Fund, which significantly increases the challenge of efficiently allocating and awarding funds, is the RAF. When applied to smaller allocations (generally less than \$10,000,000) the RAF creates funding targets in some regions that are essentially so small that they are infeasible to produce affordable housing. This particularly impacts rural and small city developments that do not have additional housing subsidies and strongly deters applicants from applying to the program.

Finally, the Department would like to note that significant improvements have been made to the program over the past two years. These improvements include greater outreach to both nonprofit and for profit developers, reduced application requirements that previously limited rural and small city developments, and increased promotion of the Housing Trust Fund as an additional subsidy to Bond and Housing Tax Credit developments in hard to develop areas. The Department is continuing to evaluate the program and its subscribership as it generates the 2006 HTF Rule.

*Responsible Employees: Director of Multifamily Finance Production,
Director of Single Family Finance Production*

Timeline for Implementation/Implementation Date: November 30, 2005

The Department's HOME and Housing Trust Fund Award Process Is Objective and Its Monitoring Procedures for Those Contracts Is Adequate, but the Department Should Correct Specific Weakness in Each Area

The Department should more consistently comply with contract award requirements for the HOME and Housing Trust Fund programs

The Department has a process to ensure that it objectively awards contracts for the HOME and Housing Trust Fund programs. Every application is reviewed by at least two reviewers and an executive awards review advisory committee before the Department's governing board votes on awards. In addition, scoring criteria are objectively applied to the applications scored for both programs, and all applicants tested are evaluated using consistent scoring and application sheets.

However, the Department did not always comply with contract award requirements for the HOME and Housing Trust Fund programs. Specifically:

- Texas Government Code, Section 2306.203, requires that the criteria used to rank Housing Trust Fund applications include the cost-effectiveness of the proposal and the leveraging of federal resources by the applicant. However, the Department did not evaluate the cost-effectiveness or leveraging of federal resources associated with all of the Housing Trust Fund rental development applications we tested. (The applications we tested totaled approximately \$700,000.) There were no scoring criteria for cost-effectiveness or leveraging on the Department's rental development scoring sheet. According to the Department, these criteria will be incorporated in the Housing Trust Fund applications for fiscal year 2005.
- According to the Code of Federal Regulations (Title 24, Part 92.201) and the Texas Administrative Code (Title 10, Sections 53.61, 53.60 and 53.50), an application for the HOME program must be scored in consideration of (1) the Department's Consolidated Plan and (2) the extent to which individuals and families with very low incomes are served by the applicant. However, in fiscal year 2004, none of the reviews of multifamily applications related to \$2.2 million in awards requested from the HOME program included scoring criteria addressing these requirements.

The Department should correct a weakness in its monitoring risk assessment for the HOME program.

The Department's monitoring procedures ensure compliance with certain HOME and Housing Trust Fund program requirements. For example, the Department's on-site monitoring procedures, desk review monitoring

procedures, and single audit procedures all comply with federal and state requirements.

However, improvements should be made in the Department's risk assessment process for the HOME program. Specifically, the Department was unable to provide support for the weighting it applied to the risk criteria that identified the contractors to which the Department would make monitoring visits. This weighting varied according to considerations that were not documented. As a result, contractors with the highest risks may not be selected for monitoring visits.

Recommendations

The Department should:

- Ensure that its reviews of Housing Trust Fund applications for rental housing development activity consider the cost-effectiveness of the proposal and the leveraging of federal resources by the applicant.
- Incorporate scoring criteria into its multifamily HOME application that address (1) the Department's Consolidated Plan and (2) the extent to which individuals and families with very low incomes are served by the applicant.
- Ensure that it is able to support the weighting applied to the monitoring risk assessment for the HOME program. The Department should also document this support.

Management's Responses

- *Recommendation – The Department should ensure that its reviews of HTF applications for rental housing development activity consider the cost-effectiveness of the proposal and the leveraging of federal resources by the applicant.*

Management's Response:

The Department amended its review and scoring process for HTF rental development applications for the 2005 funding round, prior to this report finding to include consideration of cost effectiveness and leveraging of federal resources. While the Department recognizes that it did not use leveraging as a scoring item in the 2004 funding round, applications were evaluated for cost-effectiveness, and this criteria was used as a tie-breaker in the scoring system. Furthermore, while not scored for leveraging, many of the Department's HTF applications are leveraged with other federal resources, such as Housing Tax Credits and HOME.

Responsible Employee: Director of Multifamily Finance Production

Timeline for Implementation/Implementation Date: Complete

- *Recommendation – The Department should incorporate scoring criteria into its multifamily HOME application that address (1) the Department’s Consolidated Plan and (2) the extent to which individuals and families with very low incomes are served by the applicant.*

Management’s Response:

The Department disagrees with the audit finding and recommendations for the reasons provided below.

First, the Department includes the Consolidated Plan and extent to which very-low income populations are served as threshold criteria in the evaluation of all HOME program applications, in accordance with Title 24, Part 92 of the Code of Federal Regulations. Because all applicants are required to meet threshold criteria, it would be redundant and ineffective to use these criteria for scoring purposes as well.

Furthermore, the Department disagrees with the Auditor’s assertions that it failed to incorporate these and other scoring criteria in accordance with Title 24, Part 92.201 of the Code of Federal Regulations, and §§53.60 & 53.61 of the Texas Administrative Code during the 2004 HOME multifamily application cycle. As previously noted the Department uses Title 24, Part 92.201 of the Code of Federal Regulations as threshold criteria in all application cycles. Additionally, the Department’s 2004 HOME rental development program was an open application cycle. While competitive application cycles are required to use evaluation factors outlined in 10 TAC §§53.60 & 61, open cycles do not rank or score applicants, but rather consider and evaluate for threshold criteria on a first come, first served basis. 10 TAC §53.60(c)(2)(B) states that open cycle applications will “be scored and ranked according to the scoring criteria identified in the NOFA.” The 2004 HOME rental development NOFA clearly outlined the process for evaluating applications in an open cycle, and these procedures were followed by the Department.

Responsible Employee: Director of Multifamily Finance Production

Timeline for Implementation/Implementation Date: Not applicable

- *Recommendation – The Department should ensure that it is able to support the weighting applied to the monitoring risk assessment for the HOME program. The Department should also document this support.*

Management's Response:

The Department will ensure that all weights used for risk assessment to select contractors for monitoring visits will be properly documented and justified prior to running the next risk assessment. The documentation will include adequate procedures and explanations to support the reasonableness of the weights used for scoring. This analysis and justification will result in adequate support to ensure that contractors with the highest risk are selected for monitoring visits.

Responsible Employee: Director of Portfolio Management and Compliance

Timeline for Implementation/Implementation Date: August 31, 2005

Auditor's Follow-Up Comment

The Department is not evaluating its HOME multifamily rental housing development applications in accordance with the Code of Federal Regulations (Title 24, Part 92.201) and the Texas Administrative Code (Title 10, Sections 53.61, 53.60, and 53.50). The Department evaluates its HOME multifamily rental housing development applications using a score sheet to assist it in determining whether funding should be granted to developers. The fiscal year 2004 score sheet did not include scoring criteria detailing that the Department considered Rental Housing Development applications in accordance with the Department's Consolidated Plan (i.e., the Affordable Housing Needs Score), nor did it include scoring criteria evaluating the extent to which individuals and families of very low income are affected by the proposed development project.

Automated Controls over HOME Contract Processing Are Sufficient, but the Department Should Correct a Data Integrity Issue and Strengthen Access Rights

Automated controls to process, monitor, and make contract-related payments on HOME contracts are sufficient. The Department also has appropriate transaction approval mechanisms and an adequate audit trail to track contract activity. In addition, it performs periodic reconciliations to ensure that HOME funds are consistently accounted for in (1) the U.S. Department of Housing and Urban Development's Integrated Disbursement and Information System (IDIS, the system from which the Department draws down federal funds), (2) the Department's grant accounting system, and (3) the Department's accounting system.

However, we noted a data integrity issue within the Department's contract system. Specifically, information in the contract system indicates that \$2,206,742.57 was awarded to a region labeled as "Unknown"; information in this system also indicates that \$2,196,689.26 of those funds have been spent. According to the Department, the "Unknown" label originated from address information that was missing from a predecessor system (data from the predecessor system was loaded into the contract system). The review and validation of data after it is loaded or entered into the contract system is important in ensuring data integrity because automated data edits cannot detect all types of data errors.

We also identified access issues that the Department should address. The following conditions give users too much control within the HOME contracting process and increase the risk of unauthorized payments:

- The Department's user account administrator for its contract system is also its user account administrator for IDIS. Therefore, this individual has the capability to grant access rights to create a new contract in the contract system and initiate and approve drawdowns of federal funds from IDIS. This condition is partially mitigated by (1) the fact that Department accounting personnel approve contracts in the contract system and could detect unauthorized transactions and (2) the fact that a valid voucher number from the Department's accounting system has to be established to generate a payment to a contractor, and the user account administrator does not have access to create a voucher.
- Three individuals can both initiate and approve drawdowns of HOME funds from IDIS. One of these individuals does not work for the Department, and Department personnel were not sure who this individual was. While these users cannot enter payment request vouchers into the Department's accounting system, they should not be able to both initiate

and approve drawdowns in IDIS, particularly because two of them also have supervisory duties in the Department's accounting department.

Although we identified the access issues described above, we also noted that Department staff who create and enter contracts cannot also access IDIS to draw down federal funds or access the Department's accounting system to generate a payment to a contractor. Likewise, accounting staff cannot set up new contracts in the contract system. These two conditions help ensure that no single person can create a new contract, draw down federal funds, and issue a payment from the Department's accounting system.

Recommendations

The Department should:

- Research invalid data in the contract system, determine the impact of invalid data on operations, and correct the invalid data. The Department also should ensure that data is thoroughly reviewed before and after it is loaded into the contract system.
- Require separate individuals to perform the security administration function for the contract system and IDIS.
- Ensure that no staff members have the capability to both initiate and approve drawdowns of HOME funds from IDIS.
- Determine why an individual who is not a Department employee has the capability to initiate and approve drawdowns of HOME funds and remove this individual's access.

Management's Responses

- *Recommendation – The Department should research invalid data in the contract system, determine the impact of invalid data on operations, and correct the invalid data. The Department should also ensure that data is thoroughly reviewed before and after it is loaded into the contract system.*

Management's Response:

The funds attributed to the "Unknown" region resulted from incorrect or blank zip codes in the address field of 22 contract activities migrated from a predecessor system and from two contracts with out of state contract administrator addresses. All address data has now been corrected.

Responsible Employee: Director of Portfolio Management and Compliance; Director of Information Systems Division

Timeline for Implementation/Implementation Date: Complete

- *Recommendation – The Department should require separate individuals to perform the security administration function for the contract system and IDIS.*

Management's Response:

The same individual will no longer have the administrator role for both the contract system and for IDIS. The Department has sent a request to U.S. Department of Housing and Urban Development (HUD) to assign another employee to be the IDIS administrator.

Responsible Employee: Director of Portfolio Management and Compliance

Timeline for Implementation/Implementation Date: Pending processing by HUD

- *Recommendation – The Department should ensure that no staff members have the capability to both initiate and approve draw downs of HOME funds from IDIS.*

Management's Response:

The three individuals no longer have the capability to both initiate and approve draw downs of HOME funds from IDIS. The IDIS access rights have been reviewed and adjustments have been made to ensure that proper rights are assigned to current Department staff.

Responsible Employee: Director of Portfolio Management and Compliance

Timeline for Implementation/Implementation Date: Complete

- *Recommendation – The Department should determine why an individual who is not a Department employee has the capability to initiate and approve draw downs of HOME funds and remove this individual's access.*

Management's Response:

The IDIS access rights have been reviewed and corrections have been made to ensure that proper rights are assigned to current Department staff. The Department's IDIS Administrator will periodically review IDIS access rights to ensure that proper rights are assigned.

Responsible Employee: Director of Portfolio Management and Compliance

Timeline for Implementation/Implementation Date: Complete

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

Our objectives were to:

- For the HOME Investment Partnerships (HOME) and Housing Trust Fund programs, determine whether the Department of Housing and Community Affairs (Department) (1) has a process to deliver housing services to the neediest parts of the state, (2) objectively awards contracts, (3) effectively monitors contracts, and (4) ensures that funds are disbursed in a timely manner.
- Determine whether the Department has used appropriations for the HOME and Housing Trust Fund programs in accordance with limitations and directions imposed by federal law, state law, or Departmental policy, including riders in the General Appropriations Act affecting these programs.

Scope

Our scope covered the HOME and Housing Trust Fund programs during fiscal years 2000 through 2004. We audited monitoring, contract awards, and compliance with appropriation riders related to fiscal years 2003–2004. Our audit of the Department’s housing needs assessment and awards process covered fiscal years 2000 through 2004.

Methodology

Our methodology included:

- Conducting interviews with program staff
- Performing detailed test work
- Analyzing data

Procedures and tests conducted included the following:

- Comparison of agency procedures to statutory requirements
- Tests of contractor expenditures

- Tests of contractor monitoring files
- Tests of agency awards process
- Review of reconciliation process between various information technology systems
- Review of information systems security access controls

Criteria used included the following:

- Texas Government Code, Chapter 2306
- Code of Federal Regulations, Title 24, Part 92 – Home Investment Partnerships Program
- Uniform Grant Management Standards
- General Appropriations Act (78th Legislature)

Other Information

We conducted fieldwork from March 2005 through June 2005. This audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor’s staff performed this audit:

- Courtney Ambres-Wade, CGAP (Project Manager)
- Cesar Saldivar (Assistant Project Manager)
- Vicente Arambula, CPA, MBA
- Manijeh Azmoodeh
- Lisa Collier, CPA
- Michael Dean, CGAP, CIA, MPA
- Dean Duan, CISA
- Verma Elliott, MBA
- Selvadas Govind, CIA, MBA
- Matthew Hanson
- Amadou Ngaide, MBA
- Mark Schnorrenberg, MBA

- Luis Solis
- Jim Yerich
- Scott Killingsworth, CIA (Quality Control Reviewer)
- Nicole Guerrero, MBA (Audit Manager)

General Appropriations Act, Rider 3 – Requirement to Report to the Legislative Budget Board

Rider 3, page VII-11, of the General Appropriations Act (78th Legislature) requires the following:

The housing finance division shall adopt an annual goal to apply no less than \$30,000,000 of the division’s total housing funds toward housing assistance for individuals and families in which the annual family income does not exceed the following amounts based on the number of persons in the family:

Number of Persons in the Family	Maximum Annual Income
1 Person	\$13,000
2 Persons	\$16,000
3 Persons	\$17,000
4 Persons	\$19,000
5 Persons	\$21,000

For each additional person add \$1,500. No less than 20 percent of the division’s total housing funds shall be spent for individuals and families earning between 31 percent and 60 percent of median family income. In those counties where the median family income is lower than the state average median family income, the department shall use the average state median income in interpreting this rider. The department shall provide a quarterly report to the Legislative Budget Board documenting its expenditures in each income category.

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 Jim Pitts, 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

Members of the Governing Board

Ms. Elizabeth “Beth” Anderson, Chair

Mr. C. Kent Conine, Vice Chair

Mr. Shadrick Bogany

Mr. Vidal Gonzalez

Mr. Patrick R. Gordon

Mr. Norberto Salinas

Ms. Edwina Carrington, Executive Director



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