

Arizona Department of Housing Oversight of Selected Housing Programs

Department inadequately oversaw affordable housing projects we reviewed, including paying grantees more than \$8.1 million without verifying that expenses were adequately supported and for allowable purposes such as delivering needed services to individuals experiencing or at risk of homelessness and not conducting required site inspections to ensure those individuals had safe and sanitary housing

Performance Audit

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Report 24-113

A Report to the Arizona Legislature

Lindsey A. Perry
Auditor General





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October 1, 2024

Members of the Arizona Legislature

The Honorable Katie Hobbs, Governor

Ms. Joan Serviss
Arizona Department of Housing

Transmitted herewith is the Auditor General's report, *Arizona Department of Housing—Oversight of Selected Housing Programs*. This report is in response to a November 21, 2022, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within this report a copy of the Report Highlights to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Housing agrees with all the findings and plans to implement or implement in a different manner all the recommendations. My Office will follow up with the Arizona Department of Housing in 6 months to assess its progress in implementing the recommendations. I express my appreciation to Ms. Serviss and Department staff for their cooperation and assistance throughout the audit.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,

Lindsey A. Perry

Lindsey A. Perry, CPA, CFE
Auditor General

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Audit purpose

To determine whether the Department met its statutory responsibility to oversee affordable housing programs in the State consistent with federal and State requirements and recommended practices.

Key findings

- In December 2023, the Department completed a monitoring review in response to a public complaint of a grantee contracted to provide housing and supportive services to more than 80 individuals in Apache and Navajo Counties. Its review found the grantee failed to address health and safety issues with program participants' homes, including rodent infestation and cracked walls; misused grant monies; and lacked documentation demonstrating it provided participants supportive services to help them live independently. The Department had not conducted annually required monitoring reviews of the grantee since 2019 and inadequately conducted other key oversight practices, such as verifying expenses were allowable, despite paying the grantee nearly \$1.9 million in fiscal years 2021 through 2023.
- Similarly, our review of the Department's oversight for a sample of 12 projects intended to provide special needs housing, emergency shelter, and rental housing development in calendar years 2021 through 2023 found that the Department inadequately oversaw these 12 projects, including:
 - Not conducting most required site inspections, putting participants at risk of living in unsafe or unsanitary conditions.
 - Approving and paying 22 grantee payment requests we reviewed that included more than \$8.1 million in expenses that were not supported by adequate documentation or were unallowable.
 - Inconsistently ensuring grantees submitted required project progress reports, limiting its ability to help address project delays and hold grantees accountable for providing agreed upon services.
 - Not conducting risk assessments to determine if grantees needed additional monitoring.

Key recommendations

The Department should:

- Develop and implement a written plan outlining the steps and associated timelines that it will take to implement key practices for providing program oversight consistent with federal and State requirements and recommended practices.
- Review grantee payments since 2021 to identify unallowable expenses and recover those monies.



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The Arizona Auditor General has released the first in a series of 2 audit reports of the Arizona Department of Housing (Department) as part of the Department's sunset review. This performance audit determined whether the Department's oversight of selected housing programs in calendar years 2021 through 2023 was consistent with federal and State requirements, and recommended practices. The second and final audit report determined whether the Department has developed a comprehensive performance management system, consistent with recommended practices, and provides responses to the statutory sunset factors.

Department is statutorily responsible for administering affordable housing programs in the State, including distributing federal monies to address homelessness

The Department is statutorily responsible for administering affordable housing programs in the State, including housing programs for low- and moderate-income families, and populations with special needs.^{1,2} Consistent with this responsibility, the Department distributes monies for the federal and State affordable housing programs that it administers, including State Homeless Shelter and Services Fund monies for emergency shelters, federal Continuum of Care monies to provide housing for individuals with special needs, such as individuals experiencing homelessness, and State Housing Trust Fund monies for rental housing development (see textbox, pages 1 through 3, for examples of Department housing programs, funding sources, and projects, and Arizona Auditor General report 24-114 *Arizona Department of Housing—Sunset Review*, Appendix A, for information on additional Department-administered programs and funds).^{3,4} For fiscal year 2023, the Department reported committing approximately \$1.26 billion in federal and State monies and tax credits for the various programs it administers.

Examples of Department housing programs, funding sources, and projects

Emergency shelter program

Purpose—To provide short-term, temporary lodging for individuals or families experiencing homelessness.

Funding sources—Various State funds may be used for this program. One key funding source is the State Homeless Shelter and Services Fund, which can be used for programs that provide shelter and

¹ Arizona Revised Statutes (A.R.S.) §41-3953.

² According to A.R.S. §41-3951(3), low- and moderate-income means household income that is insufficient to secure decent, safe, and sanitary housing provided by private industry without subsidized financing and that is below respective income limits established by the Department, taking into consideration such factors as the total income of the household available for housing needs and the size of the household.

³ There are 3 Continuum of Care programs in the State: (1) the Maricopa Regional Continuum of Care administered by Maricopa Association of Governments, (2) the Tucson-Pima Continuum of Care administered by the City of Tucson, and (3) the Balance of State Continuum of Care administered by the Department, which serves Arizona's remaining 13 counties.

⁴ 42 U.S.C. 11302(a) generally defines the terms "homeless," "homeless individual," and "homeless person" to include an individual or family lacking fixed, regular, and adequate nighttime residence; an individual or family with a primary nighttime residence that is a public or private place not designed for or ordinarily used as a regular sleeping accommodation for human beings; an individual or family living in a supervised publicly or privately operated shelter designated to provide temporary living arrangements; an individual who resided in a shelter or place not meant for human habitation and who is exiting an institution where he or she temporarily resided; or an individual or family who will imminently lose their housing. For example, individuals living in emergency shelters or transitional housing, such as hotels or fleeing domestic violence, are considered homeless.

services to unsheltered persons who are experiencing homelessness. For example, the Department awarded approximately \$20 million from the State Homeless Shelter and Services Fund to local jurisdictions for emergency shelter projects in fiscal year 2023. See Arizona Auditor General report 24-114, Appendix B, pages b-1 through b-14, for more information on the Homeless Shelter and Services Fund.

Example emergency shelter project—In fiscal year 2023, the Department provided the City of Phoenix with nearly \$6 million in State Homeless Shelter and Services Fund monies to help develop and operate a safe outdoor space for up to 400 people experiencing homelessness in downtown Phoenix. The safe outdoor space includes tents, restrooms, showers, security, and indoor air conditioned facilities.



Safe outdoor space provided by City of Phoenix.
Photo source: Department-provided photograph.

Special needs housing program

Purpose—To provide housing for special needs populations, including permanent supportive housing that provides long-term rental assistance and supportive services for homeless individuals with a disability, and rapid rehousing that provides temporary rental assistance and supportive services for individuals or families who are homeless or fleeing domestic violence.

Funding sources—Various federal and State programs and funds can be used for the Special Needs Housing program. Two key funding sources include:

- **Continuum of Care**—A federal program that promotes community-wide planning to address homelessness by paying for housing and supportive services for individuals experiencing homelessness. See Arizona Auditor General report 24-114, Introduction, page 2, and Appendix A, page a-2, for more information on the Continuum of Care program.
- **State Housing Trust Fund**—State monies that may be used for various purposes, including to pay for special needs housing or provide financial assistance to developers of low-income rental housing. See Arizona Auditor General report 24-114, Appendix B, pages b-1 through b-11, for more information on the State Housing Trust Fund.

In fiscal year 2023, the Department awarded approximately \$5.8 million in Continuum of Care and State Housing Trust fund monies to nonprofit organizations and local jurisdictions for special needs housing projects.

Example special needs housing project—In fiscal year 2023, the Department provided the nonprofit Catholic Charities Community Services with approximately \$600,000 in Continuum of Care and State Housing Trust Fund monies to provide permanent supportive housing for 35 homeless individuals and/or families each with at least 1 adult participant with a disability residing in Apache, Navajo, Coconino, Yavapai, and Mohave Counties.



Permanent supportive housing residence.
Photo source: Department-provided photograph.

Rental housing development program

Purpose—To provide financial support to organizations for the development of rental housing for low-income individuals or families.

Funding sources—Various federal and State programs and funds can be used for the Rental Housing Development program. The primary funding sources include federal low-income housing tax credits and State Housing Trust Fund monies. In fiscal year 2023, the Department awarded approximately \$40.6 million in State Housing Trust Fund monies to nonprofit organizations and private developers and more than \$700 million in federal Low-Income Housing Tax Credits to developers for the construction of new low-income rental housing. See Arizona Auditor General report 24-114, Introduction, pages 1 through 2, and Appendix A, page a-2, for more information on the federal Low-Income Housing Tax Credit program.

Example rental housing development project—In fiscal year 2023, the Department awarded \$2 million in State Housing Trust Fund monies to a private housing developer to help finance the construction of Salt River Flats—a low-income housing apartment complex that opened in Maricopa County in 2024. Salt River Flats has 192 housing units for households whose income is 60 percent or less of the area's median income.



Salt River Flats apartment complex.
Photo source: Department-provided photograph.

Source: Auditor General staff review and summary of Department policies and procedures, funding agreements, and provided information.

Department is responsible for overseeing grantees that provide affordable housing and services for low-income families and people experiencing or at risk of homelessness

As part of its responsibility for administering housing programs, the Department enters into funding agreements with grant recipients (grantees) to provide housing and services directly to program participants, such as individuals and communities.⁵ Department funding agreements outline the responsibilities of the Department and the grantee, applicable program requirements, a description of the services to be provided by the grantee, and the funding amount and method of payment, such as whether grant monies will be distributed to the grantee up front or on a reimbursement basis after the grantee has incurred expenses on behalf of the program. As outlined in the funding agreements and pursuant to various federal and State requirements, the Department is also responsible for overseeing grantees, which include local jurisdictions, nonprofit organizations, and private housing developers.

Our review of program oversight requirements outlined in federal regulations, the *Arizona Grants Management Manual*, funding agreements, and Department policies and procedures, as well as guidance from the U.S. Department of Housing and Urban Development (HUD), identified 4 key oversight components, including:

⁵ The Department is responsible for developing a funding review process to assess and award funding to grantees that aligns with the funding sources' missions and goals. The Department starts this process by publishing a Notice of Funding Availability (NOFA) on its website and in emailed information bulletins. An NOFA indicates what the funding may be used for, who is eligible to apply for it, and the criteria the Department will use to assess applications and award funding, such as the applicant's level of relevant experience. Once the applications have been received, the Department is responsible for assessing each application, determining which applicant(s) will be awarded funding, and developing funding agreements. See Arizona Auditor General report 24-114, Sunset Factor 5, pages 27 through 28, for information on the Department's use of stakeholder feedback for allocating funding.

(1) conducting site inspections, (2) reviewing payments, (3) reviewing progress reports, and (4) conducting risk assessments.^{6,7} Specifically, to oversee its grantees, the Department should:

- **Conduct site inspections**—Site inspections should be conducted for the Department’s affordable housing programs to ensure they meet program requirements, including health and safety standards. For example, according to federal regulations and Department policy and procedures, the Department must conduct annual monitoring reviews of each of its grantees that provide special needs housing, including visiting the grantee’s office site and conducting site inspections of participants’ homes.⁸ These annual monitoring reviews should include Department staff:
 - Interviewing grantee staff.
 - Reviewing the grantee’s financial policies and documentation.
 - Reviewing participant records to verify the grantee’s compliance with various program requirements, including ensuring the grantee accurately determined participants’ eligibility for the program.
 - Reviewing whether the grantee conducted required Housing Quality Standards (HQS) inspections of the participant’s homes to ensure they met minimum health and safety standards prior to the participant moving into the home and annually thereafter (see textbox for examples of HQS inspection requirements).⁹
 - Inspecting program participants’ homes to check for key habitability issues, such as functioning electricity and water systems, and overall safety.

Examples of HQS items grantees are required to inspect

- Doors, windows, drawers, and all hardware must be in good operating condition.
- Unit must be free from rodents and insects.
- Interior walls and ceilings must be free from cracks, holes, and peeling paint.
- Unit must have hot and cold running water that is sanitary and free from contamination.
- Plumbing fixtures must be working as designed with adequate pressure and no water leaks.
- Heating and air conditioning system must be in proper operating condition.

Source: Auditor General staff review of U.S. Housing and Urban Development. (HUD). (2022). *Inspection form*. Retrieved 6/20/2024 from <https://www.hud.gov/sites/dfiles/OCHCO/documents/52580A.PDF>

Additionally, although inspections are not specifically required for all emergency shelter and rental housing development projects, federal regulations, HUD, and the *Arizona Grants Management Manual* identify conducting regular site inspections as an oversight recommended practice.¹⁰ See Finding 1, pages 9 through 11, for issues we identified with Department site inspections.

⁶ 24 CFR 578.75(b)(1), (2), and 2 CFR 200.332 (b)(d)(e); Arizona Department of Administration (ADOA). (2018). *Arizona Grants Management Manual*. Retrieved 2/9/2024 from <https://grants.az.gov/grant-manual>; U.S. Department of Housing and Urban Development (HUD). (2021). *Managing CDBG: A guidebook for grantees on subrecipient oversight*. Retrieved 2/7/2024 from <https://files.hudexchange.info/resources/documents/CDBG-Subrecipient-Oversight-Guidebook.pdf>

⁷ HUD is the federal agency responsible for national policy and programs related to housing needs, community development, and fair housing laws.

⁸ 24 CFR 578.23(c)(8).

⁹ 24 CFR 578.75(b).

¹⁰ Projects that receive State Housing Trust Fund monies may also receive federal funds that require inspections, such as inspections conducted at 50 percent of the construction and after construction is complete for a rental housing development project. Additionally, 24 CFR 578.75(b)(1) (2) requires annual physical inspections of Continuum of Care housing.

- Ensure grantee expenses are supported and allowable**—The Department typically distributes grant monies to grantees on a reimbursement basis, meaning that grantees must first incur expenses on behalf of the program and then request that the Department reimburse them for those expenses. The Department’s policies and procedures and funding agreements require grantees to submit payment requests to the Department to receive reimbursement for expenses, which should include an itemized list of program expenses the grantee incurred and supporting documentation for those expenses, such as invoices and receipts.¹¹ For example, a grantee providing rapid rehousing services for individuals fleeing from domestic violence is required to submit a payment request that includes a list of rent and utility payments the grantee made on behalf of individuals in the program, and invoices and receipts for the rental and utility payments. Prior to distributing monies to reimburse the grantee, Department staff are required to review each grantee payment request and associated documentation to verify that the expenses were for activities and purposes outlined in the funding agreement. See Finding 1, pages 11 through 13, for issues we identified with the Department’s oversight of grantee payment requests.
- Review grantee reports to assess project progress**—The Department’s funding agreements require grantees to submit project reports to the Department for review, including periodic project progress reports and annual performance reports. For example, Homeless Shelter and Services Fund grantees must submit quarterly progress reports to the Department describing activities they have performed, any deviations from the project schedule outlined in the funding agreement, and/or unforeseen circumstances that could impact the project, such as something that could cause a project delay. Similarly, State Housing Trust Fund grantees must submit bimonthly progress reports to the Department that describe construction activities, such as the installation of windows or electrical and plumbing systems. See Finding 1, page 13, for issues we identified with the Department’s oversight of grantee reporting.
- Conduct risk assessments of each grantee**—Federal regulations and Department policy and procedures require the Department to assess each special needs housing program grantee’s risk of noncompliance with program requirements to determine the level of monitoring and/or training the Department should provide to the grantee.^{12,13} The Department developed a risk-assessment tool that uses various factors to determine a grantee’s risk of noncompliance with the funding agreement, such as the grantee’s level of experience with managing State and federal monies, the amount of grant monies awarded to the grantee in the funding agreement, and the grantee’s independent financial audit results.¹⁴ Federal regulations and Department policy and procedures outline activities the Department may implement to address a grantee’s risk of noncompliance that include providing training or technical assistance on program-related matters and performing on-site reviews. Additionally, although assessing each grantee’s risk of noncompliance to determine its level of monitoring is not specifically required for all emergency shelter and rental housing development projects, federal regulations, HUD, and the *Arizona Grants Management Manual* identify conducting risk assessments to determine the level of monitoring needed for a grantee as an oversight recommended practice.¹⁵ See Finding 1, pages 13 and 14, for issues we identified with Department risk assessments.

¹¹ The Department requires grantees to submit payment requests either monthly or quarterly depending on the housing program. For example, grantees implementing permanent supportive housing projects are required to submit monthly payment requests and grantees developing new affordable housing units are required to submit quarterly payment requests.

¹² 2 CFR 200.332(b).

¹³ According to the Department’s policies and procedures, the Department must assess a grantee’s risk for noncompliance when it issues a new funding agreement and annually thereafter.

¹⁴ An independent financial audit is an examination of an entity’s financial records, accounts, business transactions, and accounting practices by a licensed certified public accountant independent of the entity.

¹⁵ 2 CFR 200.332(b).



Department failed to provide sufficient oversight for projects we reviewed, including not ensuring grantees used monies to provide safe and sanitary housing or needed services for individuals experiencing or at risk of homelessness

In June 2023, the Arizona Attorney General’s Office forwarded a public complaint to the Department that alleged a special needs housing program grantee, the Old Concho Community Assistance Center (Community Assistance Center), had inappropriately used Continuum of Care and State Housing Trust Fund grant monies for unallowable expenses, including a \$2,000 loan payment to an executive staff member, despite these monies being intended to provide housing and supportive services for individuals experiencing homelessness (program participants). See textbox for information on the Community Assistance Center.

In response to the complaint, the Department conducted a monitoring review of the Community Assistance Center to assess the allegations that included reviewing the Community Assistance Center’s financial documentation and inspecting program participants’ homes. The Department completed its monitoring review in December 2023, approximately 6 months after it received the complaint, and 4 years after it had conducted the Community Assistance Center’s last required annual review. The Department’s monitoring-review report identified unsafe and unlivable homes, misuse of grant monies, and insufficient evidence that the Community Assistance Center had spent monies as reported and provided program participants with required supportive services to help them live independently. For example, the Department’s monitoring review found that the Community Assistance Center:

Community Assistance Center information

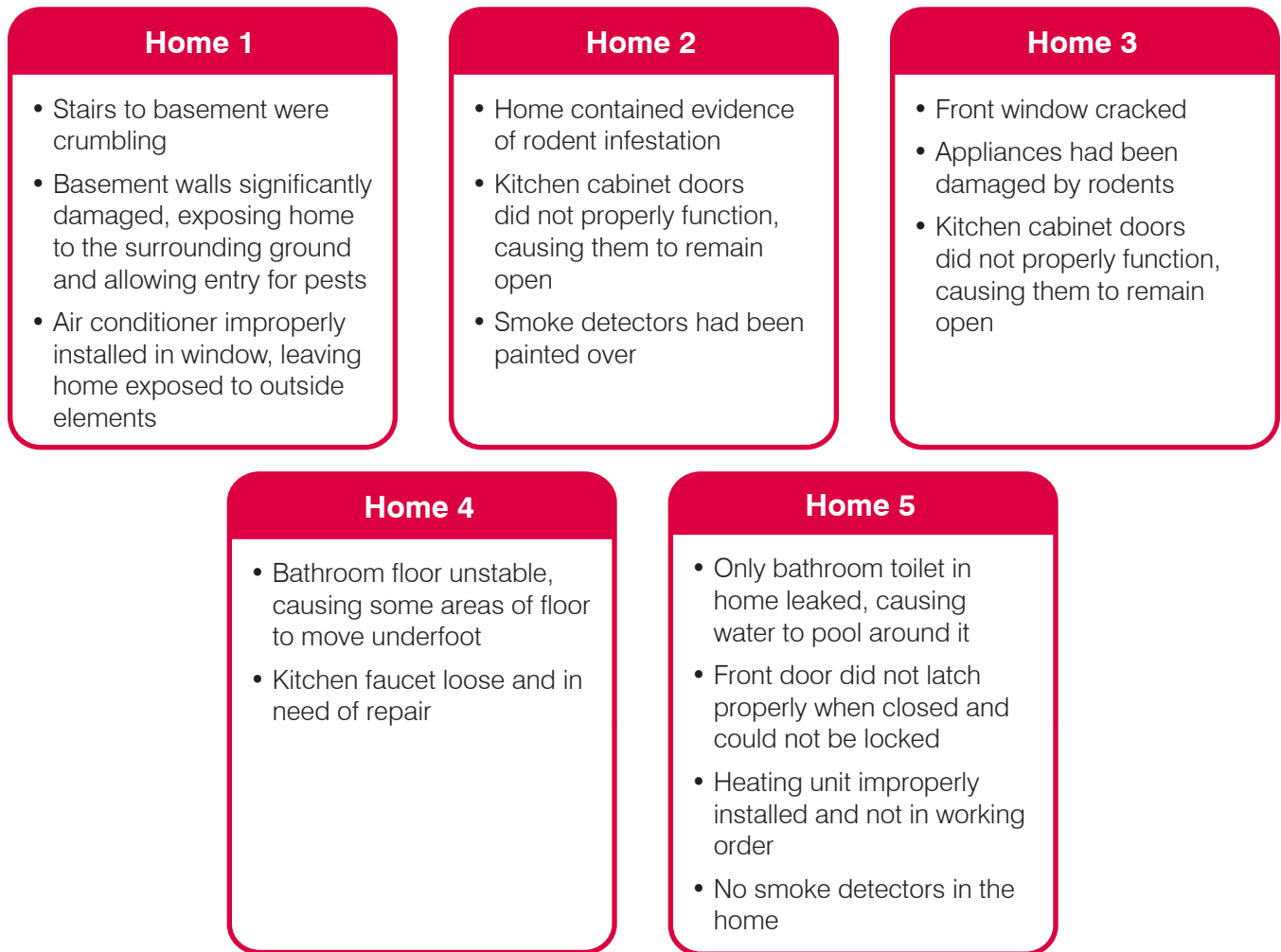
The Community Assistance Center has been a Department special needs housing program grantee since 2013. In fiscal year 2023, the Department had funding agreements with the Community Assistance Center to provide:

- 48 homeless individuals and/or families with rapid rehousing and supportive services in Apache and Navajo Counties.
- 35 homeless individuals and/or families with at least 1 adult participant with a disability with permanent supportive housing in Apache and Navajo Counties.

Source: Auditor General staff review and summary of Department funding agreements.

- **Failed to address health and safety issues with program participants’ homes, including rodent infestation, broken doors, and cracked walls that could impact participants’ safety and well-being**—As shown in Figure 1 on page 7, Department staff found health and safety issues in 5 of 6 program participants’ homes that they inspected, such as rodent infestations, broken or missing doors, and improperly installed air conditioning and heating units. Additionally, program participants and Community Assistance Center staff that the Department interviewed during its 2023 monitoring review reported that the Community Assistance Center had not completed or had disregarded program participants’ requests for repairs, including those related to health and safety issues.

Figure 1
5 program participants' homes had health and safety issues



Source: Auditor General staff review of Department's 2023 monitoring-review report.

- Misused grant monies by spending them on unallowable expenses and lacked documentation that monies it received were spent on items such as needed repairs to participants' homes—**

The Department's monitoring review of the Community Assistance Center's fiscal years 2022 and 2023 financial records found it used more than \$170,000 for unallowable expenses that the Department had previously approved (see Table 1, page 8, for information on the Department's distributions of State and federal monies to the Community Assistance Center in fiscal years 2021 through 2023). For example, the Department confirmed that the Community Assistance Center paid one of its executive staff members \$2,000 for a reported personal loan, which is not an allowable expense and thus was a misuse of public monies. The Community Assistance Center's records also indicated it spent \$37,000 in grant monies to replace water heaters and make structural repairs in participants' homes, but lacked required documentation to support that the monies were actually used to make the reported repairs consistent with federal regulations and the Department's funding agreements, such as invoices and receipts.¹⁶ Additionally, the Department's inspections of participants' homes found indications that the Community Assistance Center did not spend all the monies on the reported repairs because it had either not made the repairs or the repairs remained unfinished, creating hazardous living conditions in program participants' homes.

¹⁶ 2 CFR 200.302.

Table 1**Department distributed nearly \$1.9 million to Community Assistance Center in fiscal years 2021 through 2023**

(Unaudited)

	2021	2022	2023	Total
State Housing Trust Fund distributions	\$176,774	\$211,704	\$354,115	\$742,593
Continuum of Care distributions	396,305	408,613	346,747	1,151,665
Total	\$573,079	\$620,317	\$700,862	\$1,894,258

Source: Auditor General staff analysis of the Arizona Financial Information System/AZ360 Accounting Transaction File for fiscal years 2021, 2022, and 2023.

- Community Assistance Center lacked required documentation demonstrating it had provided participants with required supportive services to help them live independently**—Although federal regulations and the Department’s funding agreements require grantees to maintain documentation of the services they provide to program participants, the Department’s review of 15 randomly selected program participant files found that the Community Assistance Center lacked documentation it is required to maintain demonstrating it had provided 13 program participants with required case management services to help them live independently.¹⁷ Case management services can include assisting program participants to obtain medical insurance, prepare a resume, and search for employment.

The Department outlined various corrective actions that the Community Assistance Center needed to take to address the identified problems, including requiring the Community Assistance Center to conduct inspections of all participant homes and make necessary repairs, repay the Department approximately \$170,000 in grant monies used for unsupported or unallowable expenses, and provide Community Assistance Center staff with training to ensure supportive services are provided and documented. Additionally, the Department suspended payments to the Community Assistance Center and made reinstatement of payments contingent upon the Community Assistance Center completing all required corrective actions. However, as of April 2024, the Community Assistance Center had not completed many of the required corrective actions, and the Department began working with the Arizona Attorney General to collect repayment of monies made to the Community Assistance Center.^{18,19}

Finally, similar to the issues noted in the Department’s 2023 monitoring review, our State of Arizona fiscal year 2022 single audit found that the Department:

- Reimbursed the Community Assistance Center \$11,002 from State Housing Trust Fund monies, and \$47,777 from federal monies, for costs that were unsupported, unallowable, and/or paid to the Community Assistance Center’s principal officers or their immediate family for accounting and financial services, in violation of conflict-of-interest disclosure requirements.²⁰

¹⁷ 24 CFR 578.103.

¹⁸ Because the Community Assistance Center had not completed all the required corrective actions, the Department began working with a different grantee in April 2024 to take over the Community Assistance Center’s grants and provide participants with housing assistance and services.

¹⁹ As of July 2024, the Department reported it was continuing to work with the Attorney General’s Office to collect repayment of monies made to the Community Assistance Center.

²⁰ See Arizona Auditor General report *State of Arizona Single Audit Report, Year Ended June 30, 2022*. The Community Assistance Center is referred to as a nonprofit organization subrecipient in the *State of Arizona Single Audit Report, Year Ended June 30, 2022*.

- Failed to assess the Community Assistance Center’s risk of noncompliance with program requirements to determine the level of monitoring and/or training needed, as required.

The Department’s failure to conduct required annual monitoring reviews, verify that expenses were supported and allowable, and assess the Community Assistance Center’s risk of noncompliance not only resulted in it not being able to identify, mitigate, or address the problems mentioned previously, they reflect the various oversight failures we identified in this audit of the Department’s oversight practices, as outlined below, and illustrate the harm that can result to individuals in need and public monies from insufficient oversight.

Department did not adequately oversee grantees to ensure its programs are meeting their intended purpose to provide housing to individuals in need and to prevent misuse of public monies

As discussed in the Introduction (see pages 1 through 5), federal and State requirements, Department policies, and recommended practices establish key practices for providing program oversight to help ensure public monies for providing housing services to individuals in need are used for their intended purposes. However, our review of the Department’s oversight for a sample of 12 grantee projects intended to provide special needs housing, emergency shelter, or rental housing development in calendar years 2021 through 2023 found that the Department failed to adequately oversee these 12 projects, including not conducting site inspections; not consistently ensuring payments to grantees were for supported and allowable expenses; not consistently receiving and reviewing grantee reports to monitor project progress; and not assessing each grantee’s risk of noncompliance to determine its level of monitoring (see Table 2, pages 10 and 11, for a summary of each of the 12 projects we reviewed).²¹ These issues, each of which could result in wasteful and inappropriate spending of public monies and risky or unhealthy environments for vulnerable individuals such as those with disabilities and experiencing homelessness, are detailed in the following 4 issue sections.

Issue 1: Department did not conduct required site inspections, putting individuals in need at risk for living in unsafe or unsanitary conditions

Although the Department was required to conduct site inspections for 7 of 12 grantee projects we reviewed, our review found that, as of April 2024, the Department had conducted a required site inspection for only 1 of the 7 projects since the beginning of calendar year 2021.²² Specifically, during our audit in February 2024, the Department conducted a required inspection when 50 percent of construction was completed for Project 6, a rental housing development project.²³ The 6 projects that did not receive a required inspection included Project 7, for which the Department awarded more than \$1.5 million intended to provide rapid rehousing and supportive services to 45 individuals experiencing homelessness. Additionally, despite being an oversight best practice, as of April 2024, the Department had not conducted site inspections or established site inspection requirements for the other 5 grantee projects we reviewed.²⁴ These 5 projects included Project 1, for which the Department awarded more than \$13 million intended to provide temporary housing for individuals experiencing

²¹ We reviewed a stratified random sample of 10 grantee projects for which the Department awarded monies in calendar years 2021 through 2023, including 3 of 29 grantee projects that received State Housing Trust Fund monies for special needs housing or rental housing development (2 rental housing projects and 1 special needs housing project), 4 of 45 projects that received Continuum of Care monies for special needs housing, and 3 of 8 grantee projects that received Homeless Shelter and Services Fund monies for emergency shelter. Additionally, we judgmentally selected 2 grantee projects, including 1 of 45 grantee projects receiving Continuum of Care monies for special needs housing and 1 of 8 grantee projects receiving Homeless Shelter and Services Fund monies for emergency shelter (see Appendix A, page a-1, for additional information about our sample).

²² Projects 6 through 12 required inspections.

²³ The Department will also be required to conduct an inspection of this rental housing development project after construction has been completed.

²⁴ Projects 1 through 5 did not include inspection requirements.

homelessness, including an outdoor camping space for 400 individuals. The Department's lack of site inspections can hinder it from identifying and taking steps to correct situations in which individuals in need are living in unhealthy or unsafe conditions, as illustrated by the previously discussed issues related to the Community Assistance Center.

Table 2
Summary of the 12 grantee projects we reviewed¹

Project	Program	Total project funding	Purpose
Project 1 City of Phoenix	Emergency shelter	\$13,300,000	In fiscal year 2023, provide temporary housing in 2 leased hotels with 47 rooms per hotel for 1 year. Additionally, create and operate outdoor space for approximately 400 people to camp overnight.
Project 2 City of Mesa	Emergency shelter	1,000,000	In fiscal year 2023, provide temporary housing in hotel rooms for 56 homeless individuals.
Project 3 City of Flagstaff	Emergency shelter	840,000	In fiscal year 2023, provide overnight shelter in hotel rooms for 200 homeless individuals and assist 20 homeless families with move-in assistance for quick housing.
Project 4 Crossroads Nogales Mission	Emergency shelter	53,170	In fiscal year 2023, provide 14 new shelter beds and adequate linens, hygiene, and laundry supplies for shelter residents in Santa Cruz County.
Project 5 Agave House	Rental housing development	3,000,000	From December 2022 through May 2025, construct 11 rental housing units for households earning no more than 60 percent of the area median income in Pinal County.
Project 6 The Villas on Lake Mary	Rental housing development	2,000,000	From November 2022 through May 2025, construct 5 rental housing units for households earning no more than 30 percent of the area median income and an additional 4 rental housing units for households earning no more than 60 percent of the area median income in Coconino County.
Project 7 UMOM New Day Centers, Inc.	Special needs housing	1,533,782	From July 2019 through June 2023, provide rapid rehousing and supportive services, including case management for 45 homeless individuals and/or families in Maricopa County.
Project 8 Catholic Charities Community Services Northern Sky Consolidated	Special needs housing	607,198	From June 2022 through June 2023, provide permanent supportive housing for a minimum of 35 homeless individuals and/or families with at least 1 adult participant with a disability in Apache, Navajo, Coconino, Yavapai, and Mohave Counties.
Project 9 Mohave County Fresh Start	Special needs housing	289,421	From February 2022 through June 2023, provide permanent supportive housing for a minimum of 18 homeless individuals and/or families with at least 1 adult participant with a disability in Mohave County.
Project 10 Kingman Aid to Abused People	Special needs housing	210,085	From December 2021 through November 2022, provide rapid rehousing and case management services for 13 individuals and/or families who are fleeing or attempting to flee domestic violence in Mohave County.

Table 2 continued

Project	Program	Total project funding	Purpose
Project 11 Against Abuse, Inc.	Special needs housing	199,316	From October 2020 through January 2022, provide rapid rehousing and case management services for 11 individuals and/or families who are fleeing or attempting to flee domestic violence in Pinal County.
Project 12 Community Bridges, Inc.	Special needs housing	131,207	From August 2020 through July 2021, provide rapid rehousing and case management services for 8 homeless individuals and/or families in Cochise County.

¹ Although the time frames for the selected projects varied, we reviewed the Department’s oversight of the selected projects in calendar years 2021 through 2023, as applicable.

Source: Auditor General staff review and summary of Department funding agreements.

Issue 2: Department made payments to grantees without verifying that expenses were adequately supported and allowable, risking misuse of program monies

As discussed in the Introduction, the Department typically distributes program monies to grantees on a reimbursement basis, and grantees must submit payment requests including documentation demonstrating that they incurred allowable expenses to receive reimbursement. As shown in Figure 2, page 12, our review of 29 payment requests from our sample of 12 grantee projects found that the Department approved and paid 22 of 29 payment requests that included more than \$8.1 million in expenses that were not supported by adequate documentation or were unallowable.^{25,26}

Specifically, the Department:

- **Approved and paid grantees without obtaining and reviewing adequate supporting documentation demonstrating grantees incurred allowable program expenses**—Our review found 21 of 29 payment requests lacked sufficient documentation to demonstrate that grantees had incurred allowable expenses, including:
 - **More than \$7.8 million in unsupported emergency shelter expenses**—Three payment requests we reviewed included unsupported emergency shelter expenses totaling more than \$7.8 million.²⁷ For example, 1 payment request for Project 1 totaling over \$6.2 million lacked any supporting documentation for approximately \$5.4 million of the included expenses. Additionally, although the grantee provided internal accounting records for the remaining \$800,000 in expenses, it did not provide supporting invoices and/or receipts. The grantee’s payment request included various items that, pursuant to the grant agreement, would be allowable with supporting documentation, such as

²⁵ We reviewed 29 payment requests that the Department approved and paid for expenses grantees incurred in calendar years 2021 through 2023 for the 12 sampled grantee projects, including 3 randomly sampled payment requests for each of the 6 special needs housing projects, all 5 payment requests for the 4 sampled emergency shelter projects, and all 6 payment requests for the 2 sampled rental housing development projects. Three of 5 payment requests we reviewed for the 4 sampled emergency shelter projects were for expenses incurred in 2023 that the Department approved and paid in 2024.

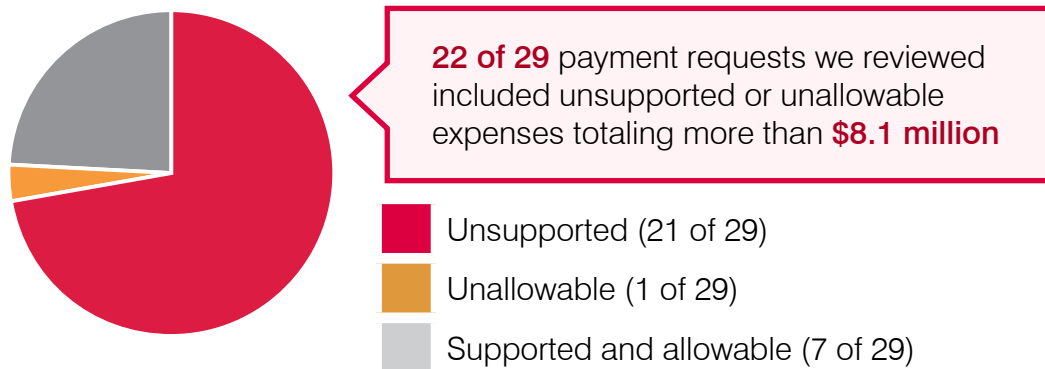
²⁶ The more than \$8.1 million in expenses that the Department approved and paid included approximately \$110,000 unsupported expenses paid in calendar year 2021, \$64,000 unsupported expenses paid in calendar year 2022, \$179,000 unsupported expenses paid in calendar year 2023, and \$7.8 million unsupported and \$4,000 unallowed expenses paid in calendar year 2024.

²⁷ 5 of 29 payment requests we reviewed included emergency shelter expenses. The 3 payment requests that included unsupported emergency shelter expenses were from Projects 1 and 2.

approximately \$3.6 million for land acquisition and buildings, \$1.7 million for relocation costs, \$600,000 for temporary lodging, and \$60,000 for facilities management.

Figure 2

In calendar years 2021 through 2024, the Department approved and paid 22 grantee payment requests with more than \$8.1 million of unsupported and/or unallowable expenses



Source: Auditor General review of payment request documentation provided by the Department.

- **More than \$190,000 in unsupported housing assistance expenses consisting of rent or lease payments**—Fifteen requests we reviewed included unsupported housing assistance expenses totaling more than \$190,000.²⁸ For example, 3 payment requests that the Department approved for Project 8, a special needs housing project, included approximately \$126,000 in housing assistance expenses that were not supported with invoices or receipts. Instead, the grantee provided copies of its internal accounting records as support for the expenses, including a list of transactions numbers without any information that would allow the Department to determine if the transactions were related to the project, such as participant names or property addresses.
- **More than \$88,000 in unsupported costs for staff administration and supportive services**—Eighteen payment requests we reviewed included expenses for administration and/or supportive services provided by grantee staff but did not include documentation with sufficient detail to determine if expenses were appropriate, such as being directly related to project administration or providing participants with supportive services.²⁹ For example, documentation included in 3 payment requests for Project 10 totaling approximately \$13,700 included staff time sheets and pay rates, but the time sheets lacked sufficient detail to determine how much time staff spent on project administration and/or providing services to program participants.

Additionally, 11 of 29 payment requests we reviewed included supportive service expenses totaling more than \$67,000, but none of these payment requests included documentation to support that program participants received the required supportive services, including case management. For example, the funding agreement for Project 7 required the grantee to provide participants with individualized services, such as moving assistance and independent living skills, but the grantee provided no documentation to demonstrate that it provided participants with these services despite being reimbursed for it.

- **Approved and paid grantee for approximately \$4,000 for expenses that were unallowable**—The Department paid the Project 4 grantee more than \$4,000 for freezers and storage cabinets, which were not included as an allowable expense in the funding agreement.

²⁸ 16 of 29 payment requests we reviewed included housing assistance expenses.

²⁹ 20 of 29 payment requests we reviewed included administration and/or supportive service expenses.

Because the Department approved payments to grantees without verifying they were for allowable expenses, the Department cannot ensure public monies were used for their intended purpose, including for providing critical housing services to individuals in need, increasing the risk of misuse of grant monies. Additionally, if the Department approves payments for expenses that are later determined to be unallowable, it may need to collect repayment of these monies from the grantee, as illustrated by the previously discussed issues related to the Community Assistance Center. Further, the Department may be required to reimburse monies used for unallowable purposes to the federal government or jeopardize future federal grants due to these deficiencies.³⁰

Issue 3: Department did not consistently ensure grantees submitted required reports, limiting Department’s ability to help address project delays and hold grantees accountable for providing agreed upon services

Although grantees are required to regularly submit project progress reports to the Department, grantees for 8 of 12 projects we reviewed either did not submit some required reports or submitted incomplete reports to the Department, and the Department also failed to take action to hold grantees accountable for providing them.³¹ For example, the grantees for Projects 1 and 2, which were awarded more than \$14 million in total to provide hundreds of individuals with temporary housing, both submitted quarterly project reports that lacked required information, including descriptions of the activities they performed in the previous 3 months and whether the project was adhering to the schedule outlined in the funding agreement. Additionally, none of the 6 special needs housing grantees we reviewed had submitted all required reports, including not submitting required bimonthly and annual project reports that should include various information on the project, including the number of participants who were provided housing assistance by the grantee. Further, although the funding agreements outline enforcement actions the Department can take to address grantee noncompliance, such as not approving grantees’ payment requests, the Department failed to take any enforcement action when the grantees failed to submit the required reports to the Department.

Lacking the information and reports that were not submitted, the Department may not be aware if grantees have failed to provide housing and/or supportive services to the number of individuals required by their funding agreements, limiting its ability to hold them accountable for spending public monies to help address the needs of individuals and families experiencing homelessness. The Department may also not be aware of problems with projects that it can help address, such as grantees that are in need of assistance or training to help achieve projects’ intended purposes.

Issue 4: Department did not conduct risk assessments to determine if grantees we reviewed needed additional monitoring

As indicated in the Introduction, risk assessments are intended to evaluate grantees’ risk of noncompliance and to establish a grantee-specific monitoring plan based on the assessment. However, the Department had not conducted risk assessments for the 6 special needs housing projects we reviewed, as required by federal regulations and Department policy and procedures (see Introduction, page 5, for information on risk-assessment requirements).^{32,33} Additionally, the Department had not conducted risk assessments consistent

³⁰ 2 CFR 200.521.

³¹ Projects 1, 2, and 7 through 12.

³² Projects 7 through 12; 2 CFR 200.332(b).

³³ The Department reported that it started implementing a risk assessment tool in July 2023 for its special needs housing projects.

with recommended practices for any of the emergency shelter projects we reviewed.³⁴ Finally, although the Department's application process for rental development projects requires it to assess risk by obtaining and reviewing information from applicants, including financial documentation and information on applicants' level of experience with developing low-income housing and any projects with ongoing noncompliance with program requirements, the Department does not use this information to determine if it should provide additional monitoring for rental housing development project grantees, which is a recommended practice. For example, the Department could use this information to determine that it needed to perform an onsite review and/or require the grantee to submit progress reports on a more frequent basis. As a result of these deficiencies, the Department's ability to identify grantees in need of additional oversight is limited, as illustrated by the Community Assistance Center previously described.

Department's failure to train staff and develop oversight processes contributed to its inadequate oversight

We identified various factors that contributed to the Department's oversight failures. Specifically:

- **Department experienced turnover in key positions resulting in staff not being adequately trained**—The Department reported that beginning in fiscal year 2021, it experienced staff turnover across all of its special needs housing program positions. This staff turnover included 4 different individuals filling the special needs housing program administrator position between July 2020 and August 2022. According to the Department, this staff turnover resulted in newly hired special needs housing program staff not receiving the needed training for overseeing and monitoring program requirements, including for reviewing grantee expenses to ensure they are supported and allowable.
- **Department staff were directed to not follow requirements for reviewing payment requests**—As we reported in our State of Arizona fiscal year 2022 single audit, a Department staff person responsible for reviewing and approving the subrecipient's reimbursement requests reported to us in October 2023 that they were trained to not follow the Department's policies and procedures but, instead, to approve any costs that had been previously reimbursed.
- **Department suspended site visits during the COVID-19 pandemic and did not immediately resume them**—The Department reported that it had suspended conducting required site inspections for its special needs housing projects in calendar year 2020 due to the COVID-19 pandemic. However, despite the impacts of the COVID-19 subsiding and the State ending Arizona's COVID-19 Emergency Declaration in March 2022, the Department did not conduct any site inspections for its special needs housing projects until the end of calendar year 2023. Additionally, the first site inspection it conducted was in response to the previously mentioned public complaint against the Community Assistance Center. The Department reported that after conducting this site inspection, it determined that it should resume conducting required site inspections. The Department reported that it conducted 3 additional site inspections in fiscal year 2024 and has developed a schedule for conducting the remaining required site inspections of special needs housing projects in fiscal year 2025.
- **Department lacked written processes for overseeing emergency shelter projects**—The Department lacked formal processes, including written policies and procedures, for overseeing projects receiving Homeless Shelter and Services Fund monies. According to the Department, it had not yet developed these oversight policies and procedures because the Homeless Shelter and Services Fund was established in October 2023.³⁵ However, as of June 2024, the Department still had not established and finalized formal processes for overseeing these projects.

³⁴ Projects 1 through 4.

³⁵ Laws 2023, Ch. 141, §3, established the Homeless Shelter and Services Fund and became effective on October 30, 2023.

Recommendations

The Department should:

1. Develop and implement a written plan that outlines steps it will take to implement the key practices for providing program oversight consistent with federal and State requirements and recommended practices, including associated completion deadlines for each step. Its written plan should include steps and deadlines for:
 - a. Conducting site inspections for all special needs housing projects it administers and oversees, consistent with federal and State requirements.
 - b. Verifying that expenses included in payment requests are supported and allowable prior to approving payments to special needs housing and emergency shelter project grantees.
 - c. Ensuring special needs housing and emergency shelter project grantees submit required project reports and Department staff review the reports to help ensure grantees are providing the services required by their funding agreements and to identify grantees that need assistance or training. Additionally, Department staff should hold grantees accountable and take enforcement action when they do not submit required reports and information, such as not approving grantees' payment requests, as necessary.
 - d. Conducting annual risk assessments for special needs housing projects and providing additional monitoring activities for grantees determined to be higher risk.
 - e. Developing and implementing a process supported by written policies, procedures, and/or guidance for the inspection of all rental housing development and emergency shelter projects, consistent with recommended practices.
 - f. Developing and implementing guidance documents for Department staff and grantees for determining whether expenses are allowable based on special needs housing and emergency shelter program requirements and funding agreements and outlining the supporting documentation that should be submitted with payment requests.
 - g. Developing written policies, procedures, and/or guidance to support the process described in Recommendation 1, part c, for emergency shelter project grantees.
 - h. Developing and implementing a process supported by written policies, procedures, and/or guidance for conducting and tracking the completion of annual risk assessments for emergency shelter projects, including the implementation of additional monitoring activities for grantees determined to be higher risk, consistent with recommended practices.
 - i. Developing and implementing a process supported by written policies, procedures, and/or guidance for using information obtained during its application process to determine additional monitoring activities for rental development project grantees determined to be higher risk, consistent with recommended practices.
2. Ensure the steps outlined in Recommendation 1 are implemented by:
 - a. Requiring program staff to provide frequent and regular reports to the Department director on the progress in implementing the steps outlined in Recommendation 1.
 - b. Developing and implementing a process for regular reporting on and review of key oversight metrics by Department leadership to ensure the sustained implementation of program oversight thereafter.
3. Evaluate its oversight processes for its other housing programs, such as the State Low Income Housing Tax Credit program, and align them with the oversight recommended practices outlined in this report, including

establishing processes for conducting inspections, reviewing payment requests, requiring reports, and conducting risk assessments.

4. Develop and provide periodic training to all relevant staff on the Department's oversight policies, procedures, guidance, and requirements, including providing training to new staff. As part of its training, the Department should explicitly notify staff that they are required to follow policies and procedures for reviewing payment requests.
5. Conduct a review of approved and paid payment requests since 2021 to identify unallowable payments made to grantees and recover those monies.

Department response: As outlined in its [response](#), the Department agrees with the finding and will implement or implement in a different manner the recommendations.



SUMMARY OF RECOMMENDATIONS

Auditor General makes 5 recommendations to the Department

The Department should:

1. Develop and implement a written plan that outlines steps it will take to implement the key practices for providing program oversight consistent with federal and State requirements and recommended practices, including associated completion deadlines for each step. Its written plan should include steps and deadlines for:
 - a. Conducting site inspections for all special needs housing projects it administers and oversees, consistent with federal and State requirements.
 - b. Verifying that expenses included in payment requests are supported and allowable prior to approving payments to special needs housing and emergency shelter project grantees.
 - c. Ensuring special needs housing and emergency shelter project grantees submit required project reports and Department staff review the reports to help ensure grantees are providing the services required by their funding agreements and to identify grantees that need assistance or training. Additionally, Department staff should hold grantees accountable and take enforcement action when they do not submit required reports and information, such as not approving grantees' payment requests, as necessary.
 - d. Conducting annual risk assessments for special needs housing projects and providing additional monitoring activities for grantees determined to be higher risk.
 - e. Developing and implementing a process supported by written policies, procedures, and/or guidance for the inspection of all rental housing development and emergency shelter projects, consistent with recommended practices.
 - f. Developing and implementing guidance documents for Department staff and grantees for determining whether expenses are allowable based on special needs housing and emergency shelter program requirements and funding agreements and outlining the supporting documentation that should be submitted with payment requests.
 - g. Developing written policies, procedures, and/or guidance to support the process described in Recommendation 1, part c, for emergency shelter project grantees.
 - h. Developing and implementing a process supported by written policies, procedures, and/or guidance for conducting and tracking the completion of annual risk assessments for emergency shelter projects, including the implementation of additional monitoring activities for grantees determined to be higher risk, consistent with recommended practices.
 - i. Developing and implementing a process supported by written policies, procedures, and/or guidance for using information obtained during its application process to determine additional monitoring activities for rental development project grantees determined to be higher risk, consistent with recommended practices (see Finding 1, pages 6 through 16, for more information).

2. Ensure the steps outlined in Recommendation 1 are implemented by:
 - a. Requiring program staff to provide frequent and regular reports to the Department director on their progress in implementing the steps outlined in Recommendation 1.
 - b. Developing and implementing a process for regular reporting on and review of key oversight metrics by Department leadership to ensure the sustained implementation of program oversight thereafter (see Finding 1, pages 6 through 16, for more information).
3. Evaluate its oversight processes for its other housing programs, such as the State Low Income Housing Tax Credit program, and align them with the oversight recommended practices outlined in this report, including establishing processes for conducting inspections, reviewing payment requests, requiring reports, and conducting risk assessments (see Finding 1, pages 6 through 16, for more information).
4. Develop and provide periodic training to all relevant staff on the Department's oversight policies, procedures, guidance, and requirements, including providing training to new staff. As part of its training, the Department should explicitly notify staff that they are required to follow policies and procedures for reviewing payment requests (see Finding 1, pages 6 through 16, for more information).
5. Conduct a review of approved and paid payment requests since 2021 to identify unallowable payments made to grantees and recover those monies (see Finding 1, pages 6 through 16, for more information).



Scope and methodology

The Arizona Auditor General has conducted this performance audit of the Department pursuant to a November 21, 2022, resolution of the Joint Legislative Audit Committee. The audit was conducted as part of the sunset review process prescribed in A.R.S. §41-2951 et seq.

We used various methods to address the audit's objectives. These methods included reviewing applicable State statutes and federal regulations; the Department's website, policies, procedures, guidance, funding agreements, and various reports; and interviewing Department staff. Additionally, we used the following specific methods to meet the audit objectives:

- To evaluate whether the Department's oversight of selected housing programs in calendar year 2021 through 2023 was consistent with federal and state requirements and recommended practices, we reviewed:
 - Program oversight requirements and recommended practices outlined in federal regulations, the *Arizona Grants Management Manual*, the Department's funding agreements, and HUD guidance.³⁶
 - Department files and data for a sample of 12 grantee projects from a population of 135 projects intended to provide special needs housing, emergency shelter, or rental housing development for which the Department awarded and distributed public monies in calendar years 2021 through 2023 to assess Department and grantee compliance with site inspection, reporting, and risk-assessment requirements and best practices.³⁷
 - A sample of 29 payment requests the Department approved and paid for from the original sample of 12 grantee projects for which the Department distributed public monies in calendar years 2021 through 2023 to determine whether the Department verified if the payment requests were for allowable expenses.³⁸
 - Department documents resulting from its investigation of a public complaint that the Arizona Attorney General's Office forwarded to the Department related to a special needs housing grantee, Old Concho Community Assistance Center.³⁹ Specifically, we reviewed various Department correspondence to the grantee and the Department's December 2023 report on its monitoring review of the grantee. Additionally, we compiled and analyzed information from the Arizona Financial Information System/*AZ360 Accounting Event Transaction File* for fiscal years 2021, 2022, and 2023.

³⁶ Arizona Department of Administration (ADOA). (2018). *Arizona Grants Management Manual*. Retrieved 2/9/2024 from <https://grants.az.gov/grant-manual>; HUD, 2021; Auditor General staff review of HUD, 2022.

³⁷ We reviewed a stratified random sample of 10 grantee projects, including 3 of 29 grantee projects that received State Housing Trust Fund monies for special needs housing or rental housing development (2 rental housing projects and 1 special needs housing project.), 4 of 45 grantee projects that received Continuum of Care monies for special needs housing, and 3 of 8 grantee projects that received Homeless Shelter and Services Fund monies for emergency shelter in calendar years 2021 through 2023. Additionally, we judgmentally selected 1 of the 45 grantee projects that received Continuum of Care monies for special needs housing and 1 of 8 grantee projects that received Homeless Shelter and Services monies for emergency shelter in calendar years 2021 through 2023. We selected these 2 projects based on the award amount and the grantee name.

³⁸ We reviewed 3 randomly selected payment requests for each of the 6 sampled special needs housing projects, all 5 payment requests for the 4 sampled emergency shelter projects, and all 6 payment requests for the 2 sampled rental housing development projects that received public monies in calendar years 2021 through 2023. See footnote 37 for details on how we selected the sample of 12 projects.

³⁹ The projects related to this grantee are not included in the sampled projects described in Footnotes 37 and 38.

- The Arizona Auditor General's *State of Arizona Single Audit Report, Year Ended June 30, 2022*.

Our work on internal controls included reviewing oversight requirements and recommended practices outlined in federal regulations, the *Arizona Grants Management Manual*, Department funding agreements, Department policies and procedures, and HUD guidance, and testing the Department's compliance with these requirements and recommended practices. We reported our conclusions on internal control deficiencies in Finding 1.

We selected our audit samples to provide sufficient evidence to support our findings, conclusions, and recommendations. Unless otherwise noted, the results of our testing using these samples were not intended to be projected to the entire population.

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

We express our appreciation to Ms. Serviss and Department staff for their cooperation and assistance throughout the audit.

DEPARTMENT RESPONSE

KATIE HOBBS
Governor



JOAN SERVISS
Director

STATE OF ARIZONA
DEPARTMENT OF HOUSING

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September 12, 2024

Lindsey Perry, CPA, CFE
Auditor General
Arizona Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

RE: Auditor General's report, Arizona Department of Housing – Oversight of Select Housing Programs

Dear Ms. Perry:

The Arizona Department of Housing (ADOH) has reviewed the Auditor General's report, *Arizona Department of Housing – Oversight of Select Housing Programs*. The Department is committed to ongoing improvement opportunities and will implement your recommendations as outlined in our response. The responses to the findings and recommendations are enclosed.

The Department appreciates the diligence and collaboration of the Office of Auditor General staff during the Sunset Review process.

Sincerely,

A handwritten signature in black ink, appearing to read "Joan Serviss".

Joan Serviss, Director
Arizona Department of Housing

Enclosure: ADOH Recommendation Response

Finding 1: Department failed to provide sufficient oversight for projects we reviewed, including not ensuring grantees used monies to provide safe and sanitary housing or needed services for individuals experiencing or at risk of homelessness

Recommendation 1: The Department should develop and implement a written plan that outlines steps it will take to implement the key practices for providing program oversight consistent with federal and State requirements and recommended practices, including associated completion deadlines for each step. Its written plan should include steps and deadlines for:

Recommendation 1a: Conducting site inspections for all special needs housing projects it administers and oversees, consistent with federal and State requirements.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department acknowledges the importance of site visits as part of the monitoring process for grantees. The Special Needs Division suspended site visits during the COVID-19 pandemic and began conducting site visits again in the fall of 2023. A monitoring schedule with site visit dates was created for FY2025 grantees. Policies and Procedures are currently being updated to ensure consistency and uniform application.

Recommendation 1b: Verifying that expenses included in payment requests are supported and allowable prior to approving payments to special needs housing and emergency shelter project grantees.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees that expenses submitted with payment requests must have supporting documentation and staff are required to verify the expenses are allowable. Policies and Procedures are currently being updated to ensure consistency and uniform application.

Recommendation 1c: Ensuring special needs housing and emergency shelter project grantees submit required project reports and Department staff review the reports to help ensure grantees are providing the services required by their funding agreements and to identify grantees that need assistance or training. Additionally, Department staff should hold grantees accountable and take enforcement action when they do not submit required reports and information, such as not approving grantees' payment requests, as necessary.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees project reports should be provided in accordance with the terms stated in a grantee's contract and reviewed by staff. Staff are required to follow-up with grantees that do not submit reports timely and utilize enforcement action as necessary. Policies and Procedures are currently being updated to ensure consistency and uniform application.

Recommendation 1d: Conducting annual risk assessments for special needs housing projects and providing additional monitoring activities for grantees determined to be higher risk.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees that annual risk assessments are required for Special Needs Housing projects grantees and should be used as a best practice for all grantees within the Special Needs Division. Staff have developed a risk assessment tool and will begin utilizing the assessment to determine which grantees are a higher risk and require additional monitoring.

Recommendation 1e: Developing and implementing a process supported by written policies, procedures, and/or guidance for the inspection of all rental housing development and emergency shelter projects, consistent with recommended practices.

Department response: The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented.

Response explanation: The Department will implement a process supported by written policies and procedures for scheduling required inspections for federal projects **or** obtaining construction progress reports for all rental housing development and emergency shelter projects

Recommendation 1f: Developing and implementing guidance documents for Department staff and grantees for determining whether expenses are allowable based on special needs housing and emergency shelter program requirements and funding agreements and outlining the supporting documentation that should be submitted with payment requests.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees staff require guidance pertaining to allowable expenses and forms of acceptable supporting documentation. Additionally, existing policies and procedures are being enhanced to ensure consistency and uniform application.

Recommendation 1g: Developing written policies, procedures, and/or guidance to support the process described in Recommendation 1, part c for emergency shelter project grantees.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: Policies and Procedures are currently being updated to ensure consistency and uniform application to support emergency shelter project grantees.

Recommendation 1h: Developing and implementing a process supported by written policies, procedures, and/or guidance for conducting and tracking the completion of annual risk assessments for emergency shelter projects, including the implementation of additional monitoring activities for grantees determined to be higher risk, consistent with recommended practices.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees and existing processes will be enhanced to ensure risk analyses are completed as part of the application review or underwriting and results will be summarized (name of entity, name of project, risk level determined).

Recommendation 1i: Developing and implementing a process supported by written policies, procedures, and/or guidance for using information obtained during its application process to determine additional monitoring activities for rental development project grantees determined to be higher risk, consistent with recommended practices.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees and will develop the procedures necessary to implement this recommendation, including action steps which could include enhanced monitoring if a grantee is deemed to be moderate to high risk.

Recommendation 2: The Department should ensure the steps outlined in Recommendation 1 are implemented by:

Recommendation 2a: Requiring program staff to provide frequent and regular reports to the Department director on their progress in implementing the steps outlined in Recommendation 1.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees the Director should be informed of progress in implementing the steps outlined in Recommendation 1 and require program staff to provide regular reports on implementation steps.

Recommendation 2b: Developing and implementing a process for regular reporting on and review of key oversight metrics by Department leadership to ensure the sustained implementation of program oversight thereafter.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees and will implement a process for regular reporting on and review of key oversight metrics by Department leadership to ensure the sustained implementation of program oversight thereafter.

Recommendation 3: The Department should evaluate its oversight processes for its other housing programs, such as the State Low Income Housing Tax Credit program, and align them with the oversight recommended practices outlined in this report, including establishing processes for conducting inspections, reviewing payment requests, requiring reports, and conducting risk assessments.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees and will evaluate the oversight processes for our housing programs and align them with recommended oversight measures and implement best practices as necessary.

Recommendation 4: The Department should develop and provide periodic training to all relevant staff on the Department's oversight policies, procedures, guidance, and requirements, including providing training to new staff. As part of its training, the Department should explicitly notify staff that they are required to follow policies and procedures for reviewing payment requests.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees with the need for staff training and will develop a periodic training schedule for existing staff and include training pertaining to policies and procedures for new hires as part of the onboarding.

Recommendation 5: The Department should conduct a review of approved and paid payment requests since 2021 to identify unallowable payments made to grantees and recover those monies.

Department response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Response explanation: The Department agrees that prior requests for payment received by the Special Needs Division should be reviewed to determine whether unallowable costs were approved. The Department will review one RFP, per quarter, per grantee since 2021 for payment requests submitted for State funds. If unallowable costs are identified, all the requests for payment submitted under that particular contract will be reviewed.

