



Issue Date	April 11, 2007
Audit Report Number	2007-AT-1007

TO: Jose R. Rivera, Director, Community Planning and Development, San Juan Field Office, 4ND

*James D. McKay*

FROM: James D. McKay, Regional Inspector General for Audit, 4AGA

SUBJECT: The Municipality of Toa Baja, Puerto Rico, Needs to Improve Its Community Development Block Grant Program Administration

## **HIGHLIGHTS**

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

We audited the Municipality of Toa Baja's (Municipality) Community Development Block Grant (Block Grant) program. We selected the Municipality for review as part of our strategic plan. The objective of the audit was to determine whether the Municipality complied with U.S. Department of Housing and Urban Development (HUD) regulations, procedures, and instructions related to the administration of the Block Grant program.

### **What We Found**

The Municipality's management controls over its housing rehabilitation activities were inadequate. It improperly used Block Grant funds for ineligible new housing construction; did not ensure that units were adequate, safe, and sanitary; and lacked adequate documentation to support program accomplishments. Therefore, program expenditures of more than \$77,000 are ineligible, and more than \$1 million is considered unsupported pending an eligibility determination by HUD.

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The Municipality's financial management system did not fully comply with applicable HUD requirements. The system did not properly allocate more than \$297,000 in administrative expenditures, did not support the allowability for more than \$107,000 in program disbursements, could not account for more than \$84,000 in Block Grant receipts, and allowed the use of more than \$12,000 for ineligible expenditures.

The Municipality awarded six contracts totaling more than \$231,000 without following HUD procurement requirements. As a result, it cannot ensure that quality goods and services were obtained at the most advantageous terms. In addition, the Municipality did not support the reasonableness of more than \$167,000 in Block Grant disbursements and paid more than \$5,000 for excessive expenditures.

### **What We Recommend**

We recommend that the director of the San Juan Office of Community Planning and Development require the Municipality to repay more than \$89,000 in ineligible expenditures and \$5,190 in excessive costs. The director should also require the Municipality to provide all supporting documentation showing the appropriateness and eligibility of more than \$1.72 million in Block Grant disbursements. We also recommend that the director require the Municipality to develop and implement an internal control plan to ensure that the Block Grant program has (1) controls and procedures which ensure that the housing rehabilitation activities meet the program objectives, (2) a financial management system that complies with HUD requirements, and (3) procurement procedures which ensure that goods and services are obtained at the most advantageous terms and in a manner providing full and open competition. In addition, we recommend that the director require the Municipality to ensure that Block Grant expenditures are properly accounted for, reconciled with HUD's disbursement system, and in compliance with HUD requirements.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

## **Auditee's Response**

We discussed the findings with the Municipality during the audit and at the exit conference on February 22, 2007. The Municipality provided its written comments to our draft report on March 5, 2007. In its response, the Municipality generally disagreed with the findings.

The complete text of the Municipality's response, along with our evaluation of that response, can be found in appendix B of this report. Attachments to the Municipality's comments were not included in the report, but are available for review upon request.

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## **BACKGROUND AND OBJECTIVES**

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The Municipality of Toa Baja (Municipality) is an entitlement recipient administering more than \$10.7 million in Community Development Block Grant (Block Grant) funds approved by the U.S. Department of Housing and Urban Development (HUD) during the past four years. HUD's Integrated Disbursement and Information System reflected Block Grant expenditures exceeding \$4 million during fiscal years 2004 and 2005 for the following activities:

<b>Block Grant activity</b>	<b>Fiscal year 2004</b>	<b>Fiscal year 2005</b>
Public facilities and improvements	\$ 1,019,489	\$ 1,123,370
Housing rehabilitation	617,670	476,563
Planning and administration	<u>417,311</u>	<u>373,282</u>
Total	<u>\$ 2,054,470</u>	<u>\$ 1,973,215</u>

The Municipality's housing department was responsible for administering the Block Grant program. Its books and records for the Block Grant and Section 108 Loan Guarantee Assistance (Loan Guarantee) programs are maintained at Road #867, Sábana Seca Avenue, Toa Baja, Puerto Rico.

We audited the Municipality's Block Grant program as part of the HUD Office of the Inspector General's (OIG) strategic plan. The Municipality was selected for review based on a risk assessment.

This is the second OIG audit of the Municipality. Audit report 2006-AT-0019, issued September 6, 2006, pointed out that the Municipality did not follow HUD requirements in the administration of its Loan Guarantee program. It did not manage two Loan Guarantee program activities in an economical, efficient, and effective manner and did not demonstrate compliance with environmental review procedures. HUD is working with the Municipality to resolve the findings in that report.

The objective of this audit was to determine whether the Municipality complied with HUD regulations, procedures, and instructions related to the administration of the Block Grant program.

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## RESULTS OF AUDIT

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### Finding 1: Management Controls over Housing Rehabilitation Activities Were Inadequate

The Municipality improperly used Block Grant funds for new housing construction; did not ensure that units were adequate, safe, and sanitary; and lacked adequate documentation to support program accomplishments. These deficiencies occurred because the Municipality lacked effective management and controls over its housing rehabilitation activities. As a result, HUD has no assurance that program objectives were met and that reported accomplishments were accurate. Therefore, program expenditures of more than \$77,000 are ineligible, and \$1 million is considered unsupported pending an eligibility determination by HUD.<sup>1</sup>

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#### Ineligible New Housing Construction

The Block Grant program allows disbursements to finance the rehabilitation cost of existing residential property. However, the cost associated with new housing construction and the creation of a secondary housing unit attached to a primary unit is not an allowable expense under the Block Grant program.

The Municipality disbursed more than \$77,000 in Block Grant funds for new housing construction in violation of HUD requirements. It approved Block Grant assistance to build or complete the construction of 33 new dwelling units.

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<sup>1</sup> Housing rehabilitation disbursements between July 1, 2004, and June 30, 2006, totaled \$1,176,655. We adjusted this amount to consider the \$107,709 questioned in recommendation 2C.



Block Grant funds were used for the construction of a new dwelling unit. This violation was not reported by the Municipality during its January 26, 2006, inspection.



Block Grant funds were used in the construction of a new dwelling unit above an existing unit. This violation was not reported by the Municipality during its June 7, 2006, inspection.



Block Grant funds were used in the construction of a new dwelling unit above an existing unit. This violation was not reported by the Municipality during its June 20, 2006, inspection.



Block Grant funds are being used in the construction of a new dwelling unit in the basement of an existing unit. The Municipality has not inspected this unit for more than a year.



A Municipality official informed us that program funds were used to complete the construction of new dwelling units because the Municipality believed that this type of work was eligible and that it had obtained HUD approval for this type of assistance. The Municipality did not provide us support showing that HUD approved the use of Block Grant funds to finance new housing construction. Further, this practice is in violation of HUD requirements in 24 CFR [*Code of federal Regulation*] 570.207.

### **Units Not Adequate, Safe, and Sanitary**

The Municipality's housing rehabilitation program guidelines provide that the main objective of the activity is to improve the condition of dwelling units, making them adequate, safe, and sanitary. The guidelines also provide that all housing rehabilitation work approved under the program must comply with federal, state, and municipal regulations and requirements. However, the Municipality did not ensure that program objectives and/or guidelines were followed. This noncompliance occurred because the Municipality did not have adequate procedures and controls over its housing rehabilitation activities.

From the Municipality's 561 units approved for assistance between July 2004 and June 2006, we selected 21 units for inspection. Our inspections found that some of the rehabilitation work was deficient or did not promote the welfare of participants. Further, some of the rehabilitation work could be in violation of local building codes.

Inadequate supporting columns, improper electrical connections, and improper installation of wooden panels were some of the deficiencies noted during our inspections.



The house is supported with concrete blocks, which makes the structure unstable and unsafe. The Municipality has not inspected this unit since December 2005.



A new bedroom (concrete structure) was added to the existing structure. The door area of the new structure had exposed reinforcement rods and no balcony, creating serious safety hazards. This unsafe condition was not reported by the Municipality during its June 16, 2006, inspection.



An improper electrical connection and missing ceiling panels created a safety hazard.



Water lines were hanging from the living room ceiling.

The Municipality's inspections did not consider whether units were adequate, safe, and sanitary or whether the repair work complied with federal or local codes as specified in its guidelines. The Municipality's inspector informed us that he only certified that the materials were used and that the repair work was completed. Municipality officials informed us that they were unfamiliar with their own guidelines and did not have written standards to ensure that units or the repair work met applicable requirements.

### **Unsupported Housing Rehabilitation Accomplishments**

According to the Municipality's records, it disbursed more than \$1 million for housing rehabilitation efforts between July 2004 and June 2006. During this period, it reported to HUD that it completed the rehabilitation work for more than 500 dwelling units. However, Municipality management did not maintain adequate internal controls to track and support the accomplishments of its housing rehabilitation activities. As a result, HUD has no assurance that program objectives were met or that reported accomplishments were accurate.

The Municipality reported in its 2004 annual performance report that 290 units were rehabilitated between July 2004 and June 2005. However, only 70 cases had a final inspection evidencing that the rehabilitation work was done. In 167 cases, all of the materials were delivered to the participants, but there was no support in the files to corroborate that the repair work was completed. In addition, the Municipality did not locate 25 housing rehabilitation case files. The Municipality's housing rehabilitation accomplishments included in the 2005 annual performance report were also unsupported. The Municipality reported that 270 dwelling units were rehabilitated between July 2005 and June 2006, but it did not provide us with a detailed list of the completed cases. Therefore, we could not corroborate the 2004 and 2005 housing rehabilitation accomplishments as reported to HUD.

The Municipality did not have in place an adequate tracking system to show the total assistance provided to each participant, the status of the repair work, the cases with due inspections, or the participants with undelivered materials. The Municipality's housing rehabilitation coordinator informed us that the Municipality would have to review each individual case file to obtain or extract the above-mentioned data.

## Other Deficiencies

We identified other deficiencies related to the administration of the housing rehabilitation activities.

Missing work specifications - The Municipality did not prepare detailed work write-ups or specifications of the rehabilitation work needed. The files only contained a general statement from the Municipality's inspector. The files did not clearly demonstrate the type of repair or the amount of assistance needed to bring the unit up to program standards. As a result, the files did not properly support the needed repairs, and the completed work assisted with Block Grant funds could not be determined. A similar deficiency was identified in the 2002 and 2004 HUD monitoring reports; however, the deficiency continues to exist.

Inspection process inadequate - The Municipality's housing rehabilitation guidelines provide that assisted dwelling units will be inspected to ensure the use of the materials provided to participants and the adequacy of rehabilitation work. Once materials are delivered, the Municipality would conduct progress inspections every 45 days and a final inspection after 90 days.

The Municipality's inspection process was inadequate, and guidelines were not followed. We found 81 cases in which the Municipality had not conducted any of the required inspections.<sup>2</sup> Of the 81 cases without inspections, the Municipality had not inspected 67 for more than a year. The Municipality inspector informed us that he was not aware that progress inspections were required every 45 days and attributed the delayed inspections to an excessive workload because of the lack of personnel.

## Conclusion

Because the Municipality did not implement adequate internal controls, it improperly used Block Grant funds for new housing construction, did not ensure that units met program standards, and did not properly support program accomplishments. Therefore, expenditures of more than \$77,000 are ineligible, and \$1 million is considered unsupported pending an eligibility determination by HUD.<sup>3</sup> Management must implement policies and procedures which ensure that it complies with HUD requirements and that program objectives are met, and emphasize that staff follows them.

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<sup>2</sup> Rehabilitation cases approved between June 2004 and July 2005.

<sup>3</sup> Housing rehabilitation disbursements between July 1, 2004, and June 30, 2006, totaled \$1,176,655. We adjusted this amount to consider the \$107,709 questioned in recommendation 2C.

## Recommendations

We recommend that the director of the San Juan Office of Community Planning and Development

- 1A. Require the Municipality to reimburse the Block Grant program from nonfederal funds \$77,811 paid for ineligible new housing construction.
- 1B. Require the Municipality to submit supporting documentation showing the current status of the repair work, the eligibility and propriety of \$1,068,946 disbursed for housing rehabilitation activities or reimburse the Block Grant program from nonfederal funds.<sup>3</sup>
- 1C. Require the Municipality to establish and implement management controls and procedures to ensure that its housing rehabilitation activities meet program objectives, that Block Grant funds are only used for eligible purposes, the rehabilitation work is properly performed and in accordance with standards, and activity accomplishments are correctly reported to HUD.



## Finding 2: The Municipality's Financial Management System Did Not Fully Comply with HUD Requirements

The Municipality's financial management system did not properly allocate more than \$297,000 in administrative expenditures, did not support the allowability of more than \$107,000 in program disbursements, could not account for more than \$84,000 in Block Grant receipts, had not disbursed more than \$34,000 in proceeds, and allowed the use of more than \$12,000 for ineligible expenditures. The noncompliance occurred because the Municipality did not develop and implement policies and procedures to ensure compliance with financial requirements of HUD programs. Consequently, the Municipality's internal controls were not sufficient to safeguard assets or ensure their use for authorized purposes and in accordance with HUD requirements.

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### **No Allocation of Salaries and Telephone Expenditures**

The Block Grant program only allows disbursements for reasonable expenditures associated with the planning and execution of community development activities that are supported by source documentation. The Municipality did not track its employees' time by program activity or implement a cost allocation plan to distribute its administrative salary and telephone expenses among HUD programs. It charged the full salary of eight employees to the Block Grant program although they performed additional functions not related to the program. The Municipality did not allocate the salaries based on the time spent by these employees on each of the programs. A similar deficiency was identified with the Municipality's telephone expenditures. The Municipality charged to the Block Grant program the full cost associated with the use of eight cellular phones and the main switchboard although they were also used by the Municipality's Section 8 program. HUD has no assurance of the reasonableness, allowability, and allocability of more than \$297,000 in administrative salaries and telephone expenses associated with costs charged to the Block Grant program between January 2004 and June 2006.

## Unsupported Program Disbursements

The Municipality did not provide adequate documentation supporting the allowability and allocability of more than \$107,000 charged to the Block Grant program associated with its housing rehabilitation activity. In March 2005, the Municipality transferred \$107,709 from the Block Grant account to its general fund as a reimbursement for payroll expenditures corresponding to the period of July 2004 through February 2005. However, it did not provide us with a list of the employees and payroll records to support the amount charged. As a result, HUD has no assurance of the reasonableness, allowability, and allocability of \$107,709 charged to the Block Grant program.

## Inaccurate Accounting Records

HUD requires recipients of Block Grant funds to maintain financial records that are accurate and current and that adequately identify the source and application of funds provided for assisted activities. The Municipality's accounting records were not accurate, current, or complete.

The Municipality's accounting records did not reflect complete and accurate financial information on program activities. For example, its accounting records did not include Block Grant fund balance accounts and did not account for capital assets acquired or constructed with HUD funds. The accounting records also contained several instances of incorrect beginning and ending balances, duplicate charges, adjustments without proper journal entries, and transactions not recorded.

In addition, the expenditures shown in the Municipality's general ledger for the fiscal year ending June 30, 2005, did not agree with amounts reflected in HUD's Integrated Disbursement and Information System.

Activity	General ledger	IDIS*	Difference
Public facilities and improvements	\$1,254,317	\$1,123,370	\$130,947
Housing rehabilitation	\$391,965	\$476,563	<\$84,598>
Administration and planning	\$410,985	\$373,282	\$37,703
Public services	\$111	0	\$111

\*Integrated Disbursement and Information System

The Municipality did not explain the discrepancies between the accounting records and could not account for \$84,598 drawn from HUD for its housing rehabilitation activity.



## **Unused Proceeds**

The Municipality's records reflected more than \$34,000 in 1991 and 1994 Loan Guarantee proceeds that had not been disbursed and remained in the Municipality's bank account. Although all Loan Guarantee activities had been completed, the Municipality had not reprogrammed these proceeds for eligible Block Grant activities. These funds had been unused by the Municipality for at least two years.

## **Ineligible Costs**

The Block Grant program allows disbursements for reasonable expenditures associated with the planning and execution of community development activities. However, the Municipality improperly used \$7,920 in Block Grant funds for expenses not associated with the program and paid \$4,215 for ineligible catering services and late payment penalties.

As a result, Block Grant funds totaling \$12,135 were improperly used for expenditures not related to program goals and objectives.

## **Conclusion**

The Municipality did not maintain a financial management system that adequately identified the source and application of Block Grant funds and that permitted only charges for allocable and allowable costs. The Municipality's Block Grant program accounting records were incomplete because they did not reflect the complete and full history of all financial transactions. As a result, HUD has no assurance that funds were adequately accounted for, safeguarded, and used for authorized purposes and in accordance with HUD requirements.

## **Recommendations**

We recommend that the director of the San Juan Office of Community Planning and Development

- 2A. Require the Municipality to determine the correct allocation of \$297,569 in administrative salaries and telephone charges, make the related accounting adjustments to its books and records, and transfer the funds to correct the allocation.
- 2B. Require the Municipality to develop and implement a financial management system to track and properly allocate its administrative expenditures among HUD programs, and that permits the tracing of funds to a level which ensures that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.
- 2C. Require the Municipality to submit all supporting documentation showing the eligibility and propriety of \$107,709 in labor costs that the Municipality charged to the Block Grant housing rehabilitation activity, or reimburse the Block Grant program from nonfederal funds.
- 2D. Require the Municipality to submit all supporting documentation showing the eligibility and propriety of \$84,598 drawn from HUD for its housing rehabilitation activity, or reimburse the Block Grant program from nonfederal funds.
- 2E. Require the Municipality to reprogram and use \$34,091 in Loan Guarantee proceeds for eligible Block Grant activity or reimburse the funds to HUD.
- 2F. Require the Municipality to reimburse the Block Grant program from nonfederal funds \$12,135 paid for ineligible expenditures.
- 2G. Require the Municipality to ensure that grant expenditures from July 2004 through October 2006 are properly accounted for, reconciled with HUD's Integrated Disbursement and Information System, and in compliance with HUD requirements.

## Finding 3: The Municipality Did Not Comply with Procurement Requirements

The Municipality awarded six contracts totaling more than \$231,000 without following HUD procurement requirements. This noncompliance occurred because the Municipality did not have in place adequate internal controls and procedures and was not familiar with applicable Block Grant requirement standards. As a result, it cannot ensure that services were obtained at the most advantageous terms. In addition, the Municipality did not support the reasonableness of \$167,555 in Block Grant disbursements and paid more than \$5,000 for excessive expenditures.<sup>4</sup>

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### Procurement Standards Not Followed

Program regulations provide that recipients shall comply with HUD procurement standards contained in 24 CFR [*Code of Federal Regulations*] 85.36. The standards include conducting procurements using full and open competition, fully documenting all procurement activities, and performing price or cost analyses.

We analyzed six contracts awarded between February and August 2005. There were at least five procurement deficiencies in all six contracts reviewed. For example, the Municipality did not

- Maintain adequate support showing that price or cost analyses were performed and the basis used to determine the reasonableness of the contracted amount,
- Provide potential contractors with complete and adequate specifications of the scope of the services to be performed,
- Ensure that requests for proposal identified all evaluation factors and their relative importance, or
- Ensure that contracts included all provisions required by 24 CFR [*Code of Federal Regulations*] 85.36(i). For example, it did not include provisions related to (1) providing HUD, the comptroller general of the United States, or any of their duly authorized representatives access to any books, documents, papers, and records of the contractor, which are directly pertinent to the specific contract for the purpose of making audit, examination, excerpts, and transcriptions, and (2) the retention of all required records for three years after the final payment and all other matters are closed.

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<sup>4</sup> Total disbursements of \$169,680 were adjusted to consider the \$2,125 questioned in recommendation 2F.

The Municipality’s bid board secretary informed us that she was not familiar with HUD procurement standards and could not ensure that the procurement process met applicable requirements. Thus, the Municipality did not provide evidence that it created an environment that permitted full and open competition as required by HUD. Appendix D has a list of the procurement deficiencies found during the review.

### Excessive Expenditures

The Municipality awarded two contracts and paid \$25,950 for legal services. Although the services were procured through requests for proposal, the Municipality did not award the procurement to the lowest proposal but, instead, split the contract between two vendors. It did not provide documentation explaining why the lowest proposal was not selected or the basis used to determine the reasonableness of the contracted amounts. As a result, the Block Grant program was charged \$5,190 for excessive expenditures.

<b>Period of services</b>	<b>Amount paid</b>	<b>Lowest proposal</b>	<b>Excessive amount</b>
August 2005 - June 2006	\$16,500	\$13,200	\$3,300
March - June 2005	<u>9,450</u>	<u>7,560</u>	<u>1,890</u>
Total	<u>\$25,950</u>	<u>\$20,760</u>	<u>\$5,190</u>

### Conclusion

The Municipality did not provide evidence that it created an environment that permitted full and open competition as required by HUD. It did not provide adequate support showing the reasonableness of \$167,555 in Block Grant contracts and paid \$5,190 in excessive expenditures. This noncompliance occurred because the Municipality did not have in place adequate internal controls and procedures and was not familiar with applicable Block Grant requirement standards. As a result, HUD has no assurance that services were obtained at the most advantageous terms and in a manner providing full and open competition or in accordance with HUD requirements.

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## Recommendations

We recommend that the director of the San Juan Office of Community Planning and Development

- 3A. Require the Municipality to provide support showing the eligibility and reasonableness of \$167,555 spent on consulting, engineering, and legal services, or reimburse the Block Grant program from nonfederal funds.<sup>5</sup>
- 3B. Require the Municipality to reimburse the Block Grant program from nonfederal funds \$5,190 paid for excessive legal services expenditures.
- 3C. Require the Municipality to develop and implement procurement procedures and controls that comply with HUD requirements to ensure that goods and services are obtained at the most advantageous terms and in a manner providing full and open competition.

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<sup>5</sup> Total disbursements of \$169,680 were adjusted to consider the \$2,125 questioned in recommendation 2F.

## SCOPE AND METHODOLOGY

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The audit objective was to determine whether the Municipality complied with HUD regulations, procedures, and instructions related to the administration of the Block Grant program. To accomplish our objectives, we

- Obtained and reviewed relevant HUD regulations and Municipality guidelines;
- Interviewed HUD, Municipality, and contractor officials;
- Reviewed monitoring and independent accountant reports;
- Reviewed the Municipality's files and records, including general ledgers;
- Performed site inspections of housing rehabilitation activities; and
- Reviewed the Municipality's controls related to the administration of its Block Grant program.

We obtained a list of housing rehabilitation grants the Municipality awarded between July 1, 2004, and June 30, 2006. During this period, the Municipality awarded 561 housing rehabilitation grants totaling \$991,838. We selected and reviewed 291 grants totaling \$544,457 that were awarded between July 1, 2004, and June 30, 2005. We reviewed each file to verify the status of the rehabilitation work and the appropriateness of the assistance provided. In addition, we inspected 21 dwelling units with grants totaling \$86,163 awarded between July 1, 2004, and May 31, 2006. The units selected for inspection were those that had an approved rehabilitation grant exceeding \$4,000 or those for which the assistance provided appeared to be for new housing construction.

The Municipality's check register reflected more than \$2.5 million in Block Grant disbursements between July 1, 2004, and May 31, 2006. We selected disbursements from the Municipality's check register with a value greater than \$10,000, resulting in a sample of 15 disbursements totaling \$959,714.<sup>6</sup> We selected 36 additional disbursements totaling \$207,595 based on the vendor or purpose of the payment. The expenditures and related supporting documents were reviewed to determine whether the payments met Block Grant requirements, including allowability and allocability of the costs.

We obtained a list of the Municipality's Block Grant procurement efforts performed between July 1, 2004, and May 31, 2006. The Municipality conducted two significant procurements, awarding six contracts totaling \$231,350. We selected and reviewed both procurements because of the small size of the population. We reviewed each file to determine whether the procurement process followed by the Municipality met HUD standards.

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<sup>6</sup> We excluded seven disbursements totaling \$487,400 because these were within the scope of the first OIG audit report of the Municipality.

To achieve our audit objectives, we relied in part on computer-processed data contained in the Municipality's database. Although we did not perform a detailed assessment of the reliability of the data, we performed a minimal level of testing and found the data to be adequate for our purposes. The results of the audit apply only to the items selected and cannot be projected to the universe or population.

The audit generally covered the period July 1, 2004, through May 31, 2006, and we extended the period as needed to accomplish our objectives. We conducted our fieldwork from July through November 2006 at the Municipality's offices in Toa Baja, Puerto Rico.

We performed our review in accordance with generally accepted government auditing standards.

# INTERNAL CONTROLS

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

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

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

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## Relevant Internal Controls

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

- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding of resources – Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.



## Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- The Municipality's management controls over its housing rehabilitation activities were inadequate (see finding 1).
- The Municipality's financial management system did not fully comply with applicable HUD requirements (see finding 2).
- The Municipality did not follow HUD procurement requirements when awarding six contracts totaling more than \$231,000 (see finding 3).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

<u>Recommendation</u>	<u>Ineligible 1/</u>	<u>Unsupported 2/</u>	<u>Unreasonable or unnecessary 3/</u>	<u>Funds to be put to better use 4/</u>
1A	\$77,811			
1B		\$1,068,946		
2A		297,569		
2C		107,709		
2D		84,598		
2E				\$34,091
2F	12,135			
3A		167,555		
3B			\$5,190	
Total	<u>\$89,946</u>	<u>\$1,726,377</u>	<u>\$5,190</u>	<u>\$34,091</u>

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

2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

3/ Unreasonable/unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, and/or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business.

4/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. This includes reductions in outlays, deobligation of funds, withdrawal of interest subsidy costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings, which are specifically identified. In this instance, if the Municipality implements our recommendations, it will use Loan Guarantee funds for eligible activities. Our estimate reflects the Municipality's account balance for the unused proceeds.

## Appendix B

# AUDITEE COMMENTS AND OIG'S EVALUATION

### Ref to OIG Evaluation

### Auditee Comments



Anibal Vega Borges  
Alcalde

Estado Libre Asociado de Puerto Rico  
**Gobierno Municipal de Toa Baja**  
Oficina del Alcalde

March 5, 2007

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Atlanta, GA, 30303-3388

**Subject: The Municipality of Toa Baja CDBG Activities**

Dear Mr. McKay:

This is in response to your letter dated February 16, 2007 related to the Audit of the Municipality of Toa Baja CDBG program. We reviewed the draft audit report and we have prepared the following comments addressing the issues in which the Municipality understands it is in compliance with the applicable regulations. The following are our comments to the draft report:

**FINDING # 1- MANAGEMENT CONTROL OVER THE HOUSING REHABILITATION ACTIVITY WERE INADEQUATE**

General comment regarding Finding 1

According to CPD's monitoring Manual a finding is defined as:

*"A deficiency in program performance based on a statutory, regulatory or program requirement for which sanctions or other corrective actions are authorized." (Chapter 1, CPD Monitoring Handbook)*

Based on the above, we understand that the finding must be revised to include only the issue that is a deficiency based on a regulatory requirement (New Construction 24 CFR 570.207(b) (3)).

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Mr. James D. McKay  
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The Municipality understands that the following items must be identified separately as concerns:

- Unit not adequate, safe and sanitary
- Unsupported housing rehabilitation accomplishments
- Missing work specifications
- Inspection process inadequate

When a deficiency is identified that results in a finding, the finding must include the condition, criteria, cause, effect, and required corrective action. For the above items the report fails to identify the criteria and does not cite the regulatory or statutory requirements that were not met because they are non-existent.

We strongly believe that the above items fall under the definition of concerns. A concern is defined as follow:

*"A deficiency in program performance not based on a statutory, regulatory or other program requirement. Sanctions or corrective actions are not authorized for concerns. However, HUD should bring the concern to the program participant's attention and, if appropriate, may recommend (but cannot require) actions to address concerns and/or provide technical assistance." (Chapter 1, CPD Monitoring Handbook)*

We request that the finding be revised and corrected to identify the deficiencies in program performance based on a statutory, regulatory or program requirement as findings and the remaining issued as concerns.

In the following paragraphs we address each of the issues identified by the IG auditor in finding number 1.

#### **Ineligible New Housing Construction**

The draft report concluded that the Municipality used CDBG funds for the new construction of 33 housing units. It appears that the OIG conclusion is based on an interpretation of the regulations as to what is considered *new construction*, and the Municipality's actions are based on a reasonable interpretation of the regulations on what is *reconstruction*. It is well to emphasize that in all 33 cases, the activity benefited very low income persons with extreme poverty and need.

The OIG reviewed 33 cases in which they determined that new construction occurred. The municipality understands that the actions taken by the homeowners constitute reconstruction and not new construction as identified by the OIG. Housing reconstruction became explicitly eligible for CDBG assistance as a result of a legislative change under section 225 Public Law 104-234, enacted April 26, 1996. This change broadened the CDBG grantees' ability to use CDBG funds for

## **Comment 1**

“reconstruction” of Housing. Although this eligibility provision was not codified in the CDBG regulations, grantees have been able to make use of this provision since approval of the legislative change.

Regarding the reconstruction activity, CPD provided guidance several times, the most recent being in 2004. CPD indicated that in the implementation of the reconstruction provision, grantees may refer to the HOME program definition of reconstruction (Letter from CPD to the Municipality dated April 8, 2004).

The auditors questioned several cases in which only a few walls or the foundations was present prior to the reconstruction. Apparently the auditors understand that when the Municipality provided funds for these units this constituted new construction. Taking into consideration CPD’s guidance, we understand that it is not a new construction. The “Welcome HOME” manual (Page 3-5) establishes under **Reconstruction Category** that funds may be used to build a new foundation or repair an existing foundation. If we follow this guidance the reconstruction of housing units where only a foundation was present is considered an eligible activity.

The following is an analysis of each of the cases questioned by the OIG and the justification for the work performed in accordance with the Law.

**Unit not adequate, safe and sanitary.**

The auditor correctly concluded that the Municipality’s rehabilitation guidelines provide that the main objective of the housing rehabilitation activity was to make the units adequate, safe and sanitary, and in compliance with federal, state, and municipal regulations and requirements. Taking this into consideration, he concluded that the Municipality did not follow its own program guide since the units rehabilitated were not adequate, safe and sanitary and did not comply with the required standards.

CDBG program regulations do not require that units rehabilitated with CDBG funds comply with local codes and standards and/or are adequate, safe and sanitary. The cost of labor, materials, supplies and other expenses required for the rehabilitation of property is an eligible type of assistance if the unit is to be occupied by low and moderate income persons, thus meeting national objectives. The CDBG regulations providing for this type of assistance do not require that the rehabilitated units be brought to standard conditions.

The inclusion of compliance with code and standards conditions in the Municipality of Toa Baja’s program guide was done following CPD’s guidance,

**Comment 2**

although this was not necessary. A letter from CPD to the Municipality dated April 9, 2004 indicates the following:

*During our visit, technical assistance was provided to Mrs. Velasquez, housing rehabilitation coordinator and staff regarding the rehabilitation activity. Under the CDBG Program, funds may be used to assist existing homeowners with the repair, rehabilitation, or reconstruction of owner occupied units. The rehabilitation activity is aimed at rehabilitation of existing structures, including substantial rehabilitation program, which typically bring the property up to local codes and standards. We want to emphasize specifically the distinctions between rehabilitation, reconstruction, and new construction.*

**Rehabilitation:** existing structures, including substantial rehabilitation program, which bring the property up to local codes and standards conditions.

When the Municipality submitted the draft guidelines to CPD at their request, CPD's comments implied the need to comply with local codes and standards. The Municipality understood that the compliance with the local codes and standards was compulsory; therefore, it was included in the guidelines.

Due to its location in a flood prone area and the extreme poverty condition of many of its residents, a significant number of the housing units in Toa Baja are in substandard conditions, constructed in wood and many of them in dilapidated conditions. Although the Municipality is very much aware of the need to bring these units to standard conditions, due to the scarce amount of funds available, the main activity of the Rehabilitation program operated by the Municipality is the provision of building materials for the repair of those housing elements which are most in need of repair, many of which are affecting the safety and security of the residents.

The Housing Rehabilitation program has been operated by the Municipality for the last twenty five years. Since its inception the Municipality never required compliance with the HQS or the local codes and standards. Following CPD's recommendations the Municipality included in the program design the provisions that are now questioned by the OIG.

We request that this item be included as a concern and not as a finding because there is no requirement in CDBG regulations concerning this aspect of rehabilitation with CDBG funds.

**Comment 3**

**Unsupported housing rehabilitation Accomplishments**

The 2004 and 2005 CAPER indicate that "assistance was provided to" a number of families. This statement is correct and clear. It is CPD's interpretation, not the Municipality's, that the statement means that the units included in the report were indeed rehabilitated and brought to standard conditions.

We disagree with the statement that the Municipality did not meet the program objectives and that the annual report was unsupported. The provision of labor and materials costs to low and moderate income families with the purpose of improving their housing conditions is consistent with the primary objective of the CDBG program. Regarding the support of the statements included in the CAPER we understand that we are in compliance with the information requested. Even though the CAPER does not require the inclusion of supporting documentation regarding the units reported, we complied with CPD's field office request for such evidence. A copy of our detailed report to CPD dated January 30, 2007 is included here for your records.

It is our understanding the OIG auditor is recommending corrective actions that the Municipality must take to address a concern, not a finding. Notwithstanding, we understand that we have taken action to resolve the concern raised by the OIG.

**Other Deficiencies**

**Missing work specifications**

The OIG concluded that the Municipality did not prepare detailed work write-ups or specifications of the rehabilitation work needed. According to the auditor the file only "contained a general statement from the Municipality's inspector". The inclusion of work specifications is not required by the CDBG regulations or by the Municipal Housing Rehabilitation Guidelines. We understand that the type of minimal rehabilitation (replacement of windows, doors and part of a roof) performed do not require detailed work specifications.

Again the OIG auditor recommends corrective actions that the program participant must take to address a concern. However, corrective actions are not required for concerns.

**Inspection process inadequate**

We agree that the inspection process needs to be improved. But again, without taking into consideration staff limitations, or the nature of the work to be performed, the inclusion in the program guidelines of numerous inspections was done following a recommendation made by CPD.

**Comment 4**

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**Comment 1**

In the conclusion section of Finding #1 the OIG determined that the use of CDBG funds for new construction was ineligible. As per our review of each one of the 33 cases mentioned by the auditor, only 8 do not qualify as reconstruction and fall under the new construction category. Therefore, we understand that the conclusion and the disallowed amount must be adjusted to take into consideration the information presented.

**Comment 5**

Regarding the \$1,000,000 in unsupported costs pending determination of eligibility, we understand that the OIG must consider eliminating this statement from the report. The eligibility of the cases was reviewed by the auditors (all families were income eligible), the housing rehabilitation activity is eligible under the CDBG regulations and the documentation to support the information reported in the CAPER was submitted to the field office on January 30, 2007.

The issues identified in finding #1 were caused by a program design that was written following CPD's field office advice and recommendations and which is not attune to the realities of the Municipality of Teo Baja. In order to correct the deficiencies the Municipality will revise the Program Guide and will streamline it in accordance with the Municipality's conditions and in full compliance with the CDBG regulations.

**Recommendation 1A**

Due to the fact that the implementation of this activity was based on a reasonable interpretation of the regulations for reconstruction, and that all cases benefited very low income persons with extreme poverty and need, we request that the economic sanction be adjusted as per the evidence presented by the Municipality.

**Recommendation 1B**

Regarding this action, we already provided the field office with the information requested by this recommendation thus we understand that we have taken the necessary corrective actions.

**Recommendation 1c**

We will revise the Program Guidelines to reflect the actual operation of the program in accordance with the regulations.

**FINDING # 2- THE MUNICIPALITY'S FINANCIAL CONTROL SYSTEM DID NOT FULLY COMPLY WITH HUD REQUIREMENTS**

**No Allocation of Salaries and Telephone Expenditures**

**Comment 6**

We disagree with the OIG determination that the salaries and other expenditures related to the administration of the Housing Department during 2004-2006 were unallowable



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under the CDBG program. HUD's regulations (24 CFR 570.206(g)) allows the use of CDBG funds to pay administrative expenses to facilitate housing. Specifically the regulations read as follow:

(g) Administrative expenses to facilitate housing. CDBG funds may be used for necessary administrative expenses in planning or obtaining financing for housing as follows: for entitlement recipients, assistance authorized by this paragraph is limited to units which are identified in the recipient's HUD approved housing assistance plan; for HUD-administered small cities recipients, assistance authorized by the paragraph is limited to facilitating the purchase or occupancy of existing units which are to be occupied by low and moderate income households, or the construction of rental or owner units where at least 20 percent of the units in each project will be occupied at affordable rents/costs by low and moderate income persons.

In addition the same regulation lists as an example the use of the funds for "Special outreach activities which result in greater landlord participation in Section 8 Housing Assistance Payments Program-Existing Housing or similar programs for low and moderate income persons" (24 CFR 570.206(g)(6).

All of the employees in the Department provide services to facilitate housing to low income population. Indeed 100% of the program participants in the section 8 program are low income persons thus we are in compliance with the national objectives of the CDBG program by benefiting low and moderate income persons.

We understand that the use of CDBG funds to cover the funds of employees that provide services to the Section 8 program and telephone expenditures that is use by all programs in the Housing Department are Administrative Expenses to Facilitate Housing thus they are eligible under 24 CFR 570.206(g).

We request that this section of the finding is eliminated from the report.

#### **Unsupported program disbursements**

During the audit the OIG staff identified a transaction in which the Housing Department reimbursed the Finance Department a total of \$107,708.54 (rounded by the OIG to \$107,709). This transaction corresponded to the reimbursement of salaries of the Housing Rehabilitation program labor brigade for the period July 1, 2004 to February 15, 2005. Although the transaction was explained to the auditors they requested additional information related to the following:

- Name of employees
- Salary
- Fringe benefit

## **Comment 7**

This information was collected and a table was prepared that is included for your review and records. The table includes the information requested and a certification that the individuals were employees of the program.

We understand that the information requested by your office is covered in this table thus we request the elimination of the finding.

#### **Inaccurate Accounting Records**

The Municipality is undertaking a reconciliation of IDIS and the General Ledger. When completed the Municipality will present a report to HUD that demonstrates compliance with the financial requirements.

#### **Unused Proceeds**

The auditors identified that a total of \$34,000 are maintained in a section 108 loan account and that apparently this action violates the Cash Management requirements (the report fails to identify the criteria and does not cite the regulatory or statutory requirements). The account where the funds are maintained is the section 108 "Guaranteed Loan Funds Account". The requirements of this account are governed by the agreement signed between the Municipality and HUD for the 1994 Section 108 Loan Guarantee. Clause 1(a) of the agreement establishes the following:

*The Guaranteed Loan Funds shall be deposited immediately on receipt in a separate, identifiable custodial account (the "Guaranteed Loan Funds Account") with a financial institution whose deposit or accounts are Federally Insured. The "Guaranteed Loan Funds Account" shall be established and designated .... And shall be continuously maintained for the Guaranteed Loan Funds. (Page 2 Contract for Loan Guarantee Assistance under Section 108 of the Housing and Community Development Act of 1974, as amended, 42 U.S.C. 5308, dated Jun 5, 1996)*

The agreements do not stipulate the use of the funds after the repayment of the loan or establish any penalties. We understand that we are in compliance with the term of the agreement. Regarding the use of the funds for other eligible activities we request that the field office request written authorization from HUD Headquarters in order to do so.

#### **Ineligible costs**

Regarding the ineligible cost questioned by the auditors we are providing evidence that shows the eligibility of reasonability of the CDBG funds expended. The report indicates

that the Municipality expended \$7,920 for activities not related to the CDBG program, \$4,215 in catering and late penalties.

**Comment 8**

Regarding the \$7,920, these funds were used to cover the cost of mobile telephones used by CDBG staff. These phones operate like radio and the users can only communicate with others members of the staff (no in-call our outcalls). These phones were used in the Housing Rehabilitation Program (3 by the inspectors, 1 by the labor Brigade supervisors, 1 by the Housing Director, 1 used as base in the Department Office). We understand that the use of the funds was related to the administration of the CDBG program and is an eligible cost. We request the revision of the draft report.

**Comment 9**

Regarding the \$4,215 used in catering and late penalties a total of \$3,469 were used in relation to CDBG activities. The following table shows the use of the CDBG funds:

Description of Activity	Amount	Date / Check #	Receipt Number
CDBG Week- Meals were provided to participants of the activities of the CDBG week.	2,513.00	5/5/04 CK 6729	1166
Meals were provided to participants of CDBG Housing Rehabilitation Program during a required orientation session.	219.50	12/9/04 CK 6906	148
Meals were provided to participants of CDBG Housing Rehabilitation Program during a required orientation session.	219.50	12/9/04 CK 6906	147
Meals were provided to participants of CDBG Housing Rehabilitation Program during a required orientation session.	219.50	12/7/04 CK 6897	145
Meals were provided to participants of CDBG Housing Rehabilitation Program during a required orientation session.	219.50	12/7/04 CK 6897	149
Meals were provided to participants of CDBG Housing Rehabilitation Program during a required orientation session.	78.00	06/29/05 CK 8061	621
<b>TOTAL</b>	<b>3,469.00</b>		

OMB Circular A-87 establishes that costs associated with the conduct of meetings and conferences include renting facilities, meals, speakers, fees, etc., are allowable. We understand that the costs identified in the above table are eligible and we request the revision of the draft report.

The remaining \$746 will be reimbursed by the Municipality using an acceptable method of repayment.

Recommendation 2A

We understand that the CBDG funds used to cover the costs of the salaries and the telephone charges are eligible thus we request the elimination of this recommendation.

Recommendation 2C

The evidence was provided with this report thus we request the elimination of this recommendation.

Recommendation 2E

We understand that authorization is needed to reprogram this funds thus the recommendation shall be rewritten to include that the field office must consult HUD Headquarters and then make the final recommendation to the Municipality.

Recommendation 2F

The recommendation shall be rewritten to include the unsupported amount of \$746.

Recommendation 2G

The Municipality is undertaking a reconciliation of IDIS and the General Ledger. When completed the Municipality will present a report to HUD that demonstrates compliance with the financial requirements.

**FINDING 3: THE MUNICIPALITY DID NOT COMPLY WITH PROCUREMENT REQUIREMENTS**

We understand that the Municipality complied with the Procurement Requirements as established in the local procurement guidelines as approved by HUD and with 24 CFR 85.36. The auditors established that the encountered deficiencies in the award of six contracts awarded between February and August 2005. Although some of the deficiencies identified by the auditors are correct, we understand that the Municipality promoted the procurement process openly and competitively. To accomplish this, the Municipality undertook the following:

- Used newspaper advertising to request the services
- The request for proposal notice included the period of contracting
- Proposals were evaluated and scores were provided to each contractor

**Comment 10**

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The method used by the Municipality was the Requests for proposals in compliance with 24 CFR 85.36(d) (3). To comply with this requirement the Municipality applied the following requirements:

- Requests for proposals were publicized and identified all evaluation factors. The Municipality only disregarded the relative importance of each factor.
- Proposals were solicited from an adequate number of qualified sources
- The municipality applied a method for conducting technical evaluations of the proposals received and for selecting awardees;
- Awards were made to the most responsible firm whose proposals was most advantageous to the program, with price and other factors considered

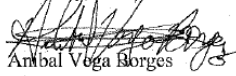
The proposals were analyzed by the Housing Department director taking into consideration the method for conducting technical evaluations. An evaluation was prepared for each proposal and a recommendation was made to the Bid Board of the Municipality. The awards were made to the most responsible firms whose proposals were most advantageous to the Municipality.

It is important to point out that during the audit period the Municipality was revising its Procurement guidelines. The guidelines were finally approved by HUD in December 2005, months after the contracting period identified by the OIG. As a result of this some of the recommendations made by the OIG are academic.

If our comments and arguments are considered and the OIG decides to implement the changes in the draft report we officially request that the new report is submitted to us for final review before the final publication on the Internet.

Before ending, I will like to extend my appreciation and thanks to Mr. Michael Rivera, and Mrs. Luisa Villalon, for the cooperation, guidance and support provided to the staff of the Municipality of Toa Baja during the audit and in the exit conference. We understand that Mr. Rivera's recommendations will result in a significant improvement in our operation of the CDBG Program.

Cordially,

  
Ambal Vega Borges  
Mayor

Enclosures

Cc: Mr. José R. Rivera  
Mr. Michael Rivera

## OIG Evaluation of Auditee Comments

The Municipality generally disagreed with our recommendations, except for recommendations 1C and 2G. Recommendations 2B, 2D, 3A, 3B and 3C were not addressed by the Municipality.

**Comment 1** The Municipality states that in 25 of the 33 units questioned the actions taken by the homeowners constitute reconstruction and not new housing construction. According to the supporting documentation the Municipality provided us during the audit, Block Grant funds were improperly used to build or complete the construction of new dwelling units and not for reconstruction of existing housing units as the Municipality claims in its response. Our review found that Block Grant funds were used for the creation of a secondary housing unit attached to a primary unit and/or new detached units that is not allowable under the program. In addition, HOME program regulations are not applicable to Block Grant activities. The Municipality did not provide additional support that could demonstrate that the expenses were eligible.

**Comment 2** The Municipality states that the Block Grant program regulations do not require rehabilitated units to comply with local codes/standards and/or make units adequate, safe, and sanitary. However, the objective of the Block Grant program is to provide annual grants to recipients to develop viable urban communities by providing decent housing and a suitable living environment, and by expanding the economic opportunities, principally for low- and moderate-income persons. Block Grant recipients must develop activities consistent with program objectives, including the elimination of conditions which are detrimental to health, safety, and public welfare, through code enforcement, demolition, interim rehabilitation assistance, and other related activities. The Municipality did not ensure that its housing rehabilitation activity was consistent with Block Grant objectives and/or its own guidelines as approved by HUD. Our inspection found that some of the rehabilitation work was deficient or did not promote the welfare of participants, possibly resulting in a waste of federal funds.

**Comment 3** The Municipality states that appropriate supporting documentation was provided to HUD on January 2007, and that it has taken action to resolve the finding. However, the additional support provided to us was not sufficient to address the deficiencies found during our audit. The information provided by the Municipality was too general and did not include names of participants, the description of the rehabilitation work needed and its status, or the amount of assistance provided to participants.

**Comment 4** The Municipality states that work specifications are not required under Block Grant regulations and that the type of minimal rehabilitation performed did not require detail specifications. However, Block Grant regulations do require recipients to maintain sufficient records that demonstrate that funds were used in an economical and efficient manner and in compliance with HUD requirements.

We agree with the Municipality that the installation of a door or window would not require detail specifications. However, our concern is related to those cases involving substantial rehabilitation work that only contained a general description. Without this information, it would be impossible to determine if the required work was completed or support the participants' needs. Our review of participant files found that the Municipality did not prepare detail work write-ups or specifications of the rehabilitation work needed. As result, the files did not properly support the needed repairs and the completed work could not be identified.

- Comment 5** The Municipality states it submitted evidence to HUD to support eligibility of \$1 million. The Municipality did not provide for our review this evidence to corroborate the eligibility and propriety of the disbursements. Therefore, the amount of \$1 million remains unsupported pending an eligibility determination by HUD.
- Comment 6** The Municipality states that the administrative functions associated with the Section 8 program are allocable to the Block Grant program since the efforts were targeted to low income population; thus, in compliance with the national objective requirement. This is contrary to requirements contained in OMB Circular A-87. In addition, HUD already pays the Municipality a fee for the administrative functions of its Section 8 program. The Municipality did not track its employees' time by program activity or implement a cost allocation plan. In addition, it did not provide us with additional support that could demonstrate that the questioned costs were allocable to the Block Grant program.
- Comment 7** The Municipality states that the \$107,709 charged to the Block Grant program were for the reimbursement of payroll expenses associated with its housing rehabilitation activities, and that it prepared a list of names, showing the alleged incurred expense, as support of its eligibility. However, the list provided by the Municipality did not include additional support that could show the reasonableness, allowability, and allocability of the expenditures.
- Comment 8** The Municipality states that it used \$7,920 to cover the cost of mobile telephones used. However, the disallowed amount corresponds to costs associated with the Disaster Recovery Grant and Section 8 programs that were improperly charged to the Block Grant program, and not for the purposes claimed by the Municipality in its response.
- Comment 9** The Municipality states that the charges associated with the catering services are allowable costs of the Block Grant program because meals were provided to participants of its housing rehabilitation activities, and that it is allowable under OMB Circular A-87. It also states that it would reimburse the costs associated with the late payment penalties.

The disallowed amount of \$4,215 corresponds to disbursements associated with catering services (\$2,400) and late payment penalties (\$1,815), not the amounts the Municipality made reference in its response.

OMB Circular A-87 does allow this type of cost when the primary purpose of which is the dissemination of technical information. According to the supporting documentation the Municipality provided us during the audit, there was no support that could show the allowability, allocability, and reasonableness of the charges or that these were associated to orientation sessions to housing rehabilitation participants as stated in its response. In five of the eight invoices examined, it only included a general statement stating that these were related to the signature of housing rehabilitation contracts. According to another invoice, breakfast and lunch was provided to 25 persons and delivered to the mayor's office, and another invoice was for snacks provided in a public hearing. The eighth invoice examined only stated that it was for 150 persons at a community center. None of the eight invoices examined had additional information on the activities for which catering services were charged to the Block Grant program. The Municipality did not provide us with additional support showing the eligibility of the catering services.

**Comment 10** The Municipality states that it complied with HUD procurement requirements. According to the supporting documentation the Municipality provided us during the audit, it awarded six contracts without following HUD procurement requirements. Thus, the Municipality did not provide evidence it created an environment that permitted full and open competition. The Municipality did not provide us with additional support that could demonstrate that services were obtained at the most advantageous terms and the reasonableness of more than \$172,000 in Block Grant disbursements.



## Appendix C

### CRITERIA

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#### **Federal Regulations at 24 [*Code of Federal Regulations*] 85.20**

Standards for financial management systems require recipients' financial management systems to provide for the following:

- Accurate, current, and complete disclosure of the financial results of financially assisted activities.
- Records which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.
- Effective control and accountability for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.
- Following applicable Office of Management and Budget cost principles, agency program regulations, and the terms of grant and subgrant agreements in determining the reasonableness, allowability, and allocability of costs.

#### **Federal Regulations at 24 [*Code of Federal Regulations*] 85.36(b)(9)**

Grantees and subgrantees will maintain records sufficient to detail the significant history of procurement. These records will include but are not necessarily limited to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.

#### **Federal Regulations at 24 [*Code of Federal Regulations*] 570.207(b)(3)**

New housing construction is an activity that may not be assisted with Block Grant funds unless authorized under provisions of §570.203 or when carried out by an entity under the provisions of §570.204.

## Appendix D

### SCHEDULE OF PROCUREMENT DEFICIENCIES

Contracted services	Amount	No cost or price analysis	Inadequate specifications of services solicited	Missing evaluating or ranking factors	Missing contract provisions	Lowest proposal not selected
Consulting services August 2005 - June 2006	\$69,600	X	X	X	X	
Engineering services August 2005 - June 2006	36,270	X	X	X	X	
Consulting services March - June 2005	30,050	X	X	X	X	
Legal services August 2005 - June 2006	16,500	X	X	X	X	X
Engineering services March - June 2005	13,000	X	X	X	X	
Legal services March - June 2005	<u>9,450</u>	X	X	X	X	X
Total	<u>\$174,870</u>	6	6	6	6	2

\*\* The schedule does not indicate all violations noted during the review. We only included the most frequent and serious violations.