



Issue Date June 6, 2008
----------------------------

Audit Report Number 2008-AT-1008
-------------------------------------

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 Carolina, Puerto Rico, Needs to Improve Procurement of Its Housing Rehabilitation Activities

## **HIGHLIGHTS**

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

We audited the Municipality of Carolina'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 HUD and its own regulations, procedures, and instructions related to the administration of the Block Grant program.

### **What We Found**

The Municipality generally complied with requirements of the Block Grant program. However, we found deficiencies associated with the procurement of its housing rehabilitation activities. The Municipality awarded 65 housing rehabilitation contracts totaling more than \$400,000 without following HUD and its own procurement requirements. As a result, it obtained goods and services without full and open competition. In addition, the Municipality did not support the reasonableness of more than \$81,000 in Block Grant disbursements.

## **What We Recommend**

We recommend that the Director of the San Juan Office of Community Planning and Development require the Municipality to provide support showing the eligibility and reasonableness of more than \$81,000 or reimburse the Block Grant program from nonfederal funds. The director should also require the Municipality to 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.

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 directive issued because of the audit.

## **Auditee's Response**

We discussed the findings with the Municipality and HUD officials during the audit. We provided a copy of the draft report to Municipality officials on April 30, 2008, for their comments and discussed the report with the officials at the exit conference on May 8, 2008. The Municipality did not provide written comments to our report and informed us that it will address the recommendations directly with the San Juan Office of Community Planning and Development.

## TABLE OF CONTENTS

---

Background and Objectives	4
Results of Audit	
Finding 1: The Municipality Did Not Comply with Procurement Requirements	5
Scope and Methodology	8
Internal Controls	9
Appendixes	
A. Schedule of Questioned Costs	10
B. Criteria	11

## **BACKGROUND AND OBJECTIVES**

---

The Municipality of Carolina (Municipality) is an entitlement recipient administering more than \$18.9 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 \$9 million during fiscal years 2005 and 2006 for the following activities:

<b>Block Grant activity</b>	<b>Fiscal year 2005</b>	<b>Fiscal year 2006</b>
Planning and administration	\$1,068,851	\$912,044
Housing rehabilitation	661,859	974,575
Public facilities and improvements	744,687	1,653,056
Public services	107,193	253,182
Section 108 loan repayments	<u>1,378,270</u>	<u>1,341,912</u>
Total	<u>\$ 3,960,860</u>	<u>\$ 5,134,769</u>

The Municipality's Community Planning and Development Office was responsible for administering the Block Grant program. Its books and records for the Block Grant programs are maintained at Ignacio Arzuaga Street, Carolina, Puerto Rico.

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

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

## RESULTS OF AUDIT

---

### Finding 1: The Municipality Did Not Comply with Procurement Requirements

The Municipality awarded 65 housing rehabilitation contracts totaling more than \$400,000 without following HUD and its own procurement requirements. This noncompliance occurred because the Municipality believed that competitive procurement was unfeasible. As a result, it obtained goods and services without full and open competition. In addition, the Municipality did not support the reasonableness of more than \$81,000 in Block Grant disbursements.

---

#### 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 obtaining price or rate quotations from an adequate number of qualified sources. In addition, the Municipality's procurement regulation requires the grantee to obtain at least three quotations or cost proposals for construction or rehabilitation work that does not exceed \$100,000.

We analyzed 65 housing rehabilitation contracts paid between July 2006 and September 2007. There were procurement deficiencies in all 65 contracts reviewed. The Municipality did not obtain price or rate quotations from an adequate number of qualified sources and did not provide documentation explaining the rationale used for the contractor selection.

A Municipality official informed us that noncompetitive procurement was used by selecting the contractor from a prequalified list and awarding the contract based on the availability of the contractor.<sup>1</sup> Thus, the Municipality did not ensure that the procurement of its housing rehabilitation activities complied with HUD requirements. It did not provide evidence that it created an environment that permitted full and open competition or that HUD authorized the use of noncompetitive procurement.

The Municipality also maintained that competitive procurement would be burdensome to the program because the dwelling units were scattered throughout

---

<sup>1</sup> The contract amount was determined using the Municipality's independent cost estimate.

the city and the amount of the repair work was under \$10,000. However, it did not provide documentation explaining how competitive procurement would adversely affect the housing rehabilitation activities.

### **Unsupported Administrative Expenditures**

The Municipality awarded 65 contracts and paid \$407,322 for housing rehabilitation efforts within the Municipality. Although the Municipality prepared independent cost estimates for each dwelling unit, it did not provide adequate support showing the reasonableness of more than \$81,000 in administrative (overhead and profit) costs paid with Block Grant funds. Therefore, HUD had no assurance of the reasonableness and propriety of the costs.

The Municipality added a 25 percent markup to the total estimated amount of the repair work.<sup>2</sup> Municipality officials informed us that the markup was associated with the contractor's administrative costs and that this amount (25 percent markup) was adopted after a September 2005 meeting with the housing rehabilitation contractors. The Municipality did not provide documentation showing how the markup was determined or the basis used to determine its reasonableness. Therefore, the reasonableness of the administrative costs was not supported.

### **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 more than \$81,000 in Block Grant disbursements. This noncompliance occurred because the Municipality believed that competitive procurement was unfeasible. As a result, HUD lacked 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.

---

<sup>2</sup> A fixed priced contract was awarded for the totality of the repair work cost estimate plus the 25 percent markup.

## Recommendations

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

- 1A. Require the Municipality to provide support showing the eligibility and reasonableness of \$81,143 spent on administrative costs or reimburse the Block Grant program from nonfederal funds. Any amounts determined ineligible must be reimbursed to the Block Grant program from nonfederal funds.
- 1B. Require the Municipality to 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.

## SCOPE AND METHODOLOGY

---

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

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

We obtained a list of housing rehabilitation (citywide) grants the Municipality disbursed between July 1, 2006, and September 30, 2007. During this period, the Municipality disbursed 65 housing rehabilitation grants totaling \$407,322. We reviewed the 65 housing rehabilitation grants to determine whether the procurement process followed by the Municipality met HUD standards.

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, 2006, through September 30, 2007, and we extended the period as needed to accomplish our objectives. We conducted our fieldwork from November 2007 through March 2008 at the Municipality's offices in Carolina, Puerto Rico.

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



# INTERNAL CONTROLS

---

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.

## 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 item is a significant weakness:

- The Municipality did not follow HUD procurement requirements when awarding 65 contracts totaling more than \$400,000 (see finding 1).

## APPENDIXES

---

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

---

<u>Recommendation number</u>	<u>Unsupported 1/</u>
1A	\$81,143
Total	<u>\$81,143</u>

1/ 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.

## Appendix B

### CRITERIA

---

#### **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 procurements. 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*] 85.36(c)(1)**

All procurement transactions will be conducted in a manner providing full and open competition.

#### **Federal Regulations at 24 [*Code of Federal Regulations*] 85.36(d)(4)(i)**

Procurement by noncompetitive proposals may be used only when procurement through small purchase procedures is unfeasible and one of the following applies: (1) item is available only from a single source, (2) a public emergency or exigency exists, (3) the awarding agency authorizes it, or (4) competition is deemed inadequate after solicitation from various sources.