



Issue Date July 21, 2011

Audit Report Number 2011-LA-1014

TO: Melina Whitehead, Acting Director, San Francisco Office of Public Housing,
9APH

\\ \\ SIGNED \\ \\

FROM: Tanya E. Schulze, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Housing Authority of the County of Monterey, Salinas, CA, Did Not
Administer the Procurement and Contracting of Its Capital Fund Recovery Grant
Funds in Accordance With HUD Laws and Regulations

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the County of Monterey's (Authority) administration of more than \$2.9 million in Capital Fund Recovery Grant funding as part of the American Recovery and Reinvestment Act of 2009. We conducted the audit because the Authority had received more than \$2.9 million in Recovery Act grants. In addition, the San Francisco U.S. Department of Housing and Urban Development (HUD) Office of Public Housing had expressed concerns regarding the use of the funds.

Our objective was to determine whether the Authority administered the procurement and contracting of its grant funds in accordance with HUD laws and regulations.

What We Found

The Authority did not administer the procurement and contracting of \$99,900 in grant funds in accordance with HUD laws and regulations. It did not follow HUD's or its own procurement policies and procedures when it procured grant-funded construction contracts.

The Authority also included required geographic preference clauses in its grant-funded construction contracts. These clauses restricted the procurement process in a manner that was not fair and open to competition.

What We Recommend

We recommend that the Director of HUD's San Francisco Office of Public Housing require the Authority to

- Provide to HUD documentation of at least three written price quotations showing justification for the \$99,900 in unsupported costs incurred for electrical wiring upgrades at 15 housing units. This documentation should include a tabulation of quotations received, certified, and retained by the Authority. Otherwise, the Authority should repay HUD \$99,900 from non-Federal funds for the unsupported payments incurred.
- Conduct all future procurements in compliance with HUD laws and regulations to ensure fair and open competition. If the Authority does so, it will avoid instances such as the roofing and solar panel installation contracts identified in this report that were conducted with limited competition.
- Establish a record-keeping system that ensures complete, consistent, and accurate documentation of all future procurements to ensure compliance with HUD laws and regulations.
- Provide appropriate training to responsible personnel to ensure better understanding of HUD procurement laws and regulations.

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 provided the Authority a discussion draft report on July 7, 2011, and held an exit conference with Authority and HUD officials on July 14, 2011. The Authority provided a written response to the report on July 15, 2011, and generally agreed with our finding.

The complete text of the Authority's response, along with our evaluation of that response, can be found in appendix B of this report.

TABLE OF CONTENTS

Background and Objective	5
Results of Audit	
Finding: The Authority Did Not Administer the Procurement and Contracting of Its Grant Funds in Accordance With HUD Laws and Regulations	6
Scope and Methodology	9
Internal Controls	10
Appendixes	
A. Schedule of Questioned Costs	12
B. Auditee Comments and OIG's Evaluation	13
C. Criteria	19

BACKGROUND AND OBJECTIVE

The purpose of the American Recovery and Reinvestment Act of 2009 Capital Fund Recovery Grant program was to provide an additional \$995 million to public housing authorities for capital and management activities as authorized under Section 9 of the United States Housing Act of 1937 in accordance with four funding categories:

- Improvements addressing the needs of the elderly and/or persons with disabilities;
- Public housing transformation;
- Gap financing for projects that are stalled due to financing issues; and
- Creation of energy-efficient, green communities.

The Housing Authority of the County of Monterey administered its allocated amount of more than \$2.9 million toward capital improvement projects such as roofing, electrical wiring upgrades, and solar panel installation at select housing developments and units.

The Authority was created under the authority of the Health and Safety Code by Resolution, which identified a need for safe and sanitary low-income housing, by the Monterey County Board of Supervisors on March 21, 1941. The Authority provides a variety of housing and services to low- and moderate-income residents of Monterey County. The Authority is supported by grants and special allocations from the U.S. Department of Housing and Urban Development (HUD) and State of California housing programs. In addition, the Monterey County Inclusionary Housing Fund often provides seed money for housing development projects. The agency receives no general fund allocation, tax increment revenue, or special funding from the State of California, the County of Monterey, or any city government.

Our objective was to determine whether the Authority administered the procurement and contracting of its grant funds in accordance with HUD laws and regulations.

RESULTS OF AUDIT

Finding: The Authority Did Not Administer the Procurement and Contracting of Its Grant Funds in Accordance With HUD Laws and Regulations

The Authority did not administer the procurement and contracting of its grant funds in accordance with HUD laws and regulations. We attributed this problem to the Authority's not having a clear understanding of which procurement method to use. As a result, the Authority did not ensure that the procurement of a construction contract totaling \$99,900 was supported and justified. It also did not ensure two other grant-funded construction contracts were procured in a manner that allowed for fair and open competition.

Fifteen Unit Electrical Wiring Upgrade Contract Was Not Properly Procured

According to the Authority, the electrical wiring upgrade work for 17 housing units was needed due to potential fire hazards involving the use of aluminum wiring. Due to uncertainties involving the wiring configurations behind the housing unit walls, the Authority started this upgrade project by soliciting price quotes for work on two housing units. It solicited three contractors but received only two bids. From the two price bids, the Authority selected a contractor with the lower price quote to perform the upgrade work for \$20,788, or \$10,394 per unit. This contract did not include options or contingency clauses to retain the contractor for additional work.

Before completing the contracted work, the Authority asked the same contractor to provide a price quote for similar work on the remaining 15 housing units. The Authority and contractor were able to negotiate a lower per unit price of \$6,660 for a total of \$99,900. The Authority did not solicit the required minimum three price quotes because it believed its solicitation from the prior procurement was sufficient. According to Authority officials, there was a meeting that included the former executive director to discuss the execution of the \$99,900 contract and how to proceed with the work. The Authority was unable to provide documentation showing that the former executive director agreed to the price quote for work to begin.

These contracts were separate procurements that fell within the small purchase threshold. For the \$99,900 contract, the Authority did not solicit price quotes from an adequate number of contractors as required by HUD for small purchases under \$100,000. The Authority's own procurement policies and procedures for

small purchases, specifically section (II)(A)(3)(c)(i), require it to solicit three written price quotes for procured work. In this case, the Authority did not provide documentation to show that it had solicited written price quotes from the minimum number of contractors as required. In addition, it lacked procurement history documentation and, therefore, violated the regulation at 24 CFR 85.36(b)(9) that the Authority maintain records sufficient to detail the procurement. Without the required documentation of the procurement history, the Authority was unable to demonstrate that its procurement was conducted with fair and open competition. Also, it could not support or justify the expenditure of \$99,900 in grant funds used towards the electrical upgrade work at 15 housing units.

The Authority's Use of Geographic Preference Clauses Prohibited Fair and Open Competition

The Authority awarded two contracts totaling more than \$1.9 million using geographic preference clauses as a requirement for obtaining the contracts. The Authority's inclusion of geographic preference clauses violated HUD procurement laws and regulations, as well as restricting the procurement process in a manner that was not fair and open to competition. Regulations at 24 CFR (Code of Federal Regulations) 85.36(d)(1) require the Authority to conduct procurements in a manner that prohibits the use of statutorily or administratively imposed in-State or local geographic preferences in the evaluation of bids or proposals, except in those cases in which applicable Federal statutes expressly mandate or encourage geographic preference. HUD's Office of General Counsel (OGC) provided a legal opinion addressing whether the Authority's use of geographic preference clauses as conditions to obtaining the contract violated HUD laws and regulations. According to OGC's legal opinion, the Authority's use of such geographic preference clauses violated HUD laws and requirements. For future procurements involving HUD funds, it should award contracts without the use of geographic preference clauses to ensure fair and open competition.

Solar Panels Installation Contract

In October 2009, the Authority awarded more than \$1.2 million in grant-funded contracts for the installation of solar panels at its housing developments with the requirement that the contractor hire local area youth. Also, at least 50 percent of the workforce on the project had to be from the local area. The Authority's requirements prevented conducting the procurement in a manner that was fair and open to competition.

Roofing Construction Contract

In May 2009, the Authority awarded a \$753,077 grant-funded roofing contract with the requirement that the contractor hire local area youth as part of its workforce. Such a requirement used by the Authority prevented the procurement from being conducted in a manner that was fair and open to competition.

Conclusion

We attributed the problems described above to the Authority's not having a clear understanding of which procurement method to use in ensuring that its procurements complied with HUD laws and regulations. As a result, the Authority did not provide assurance that a \$99,900 grant-funded construction contract was supported and justified. It also did not provide assurance that the procurement of two other grant-funded construction contracts were conducted in a manner that promoted fair and open competition.

Recommendations

We recommend that the Director of HUD's San Francisco Office of Public Housing require the Authority to

- 1A. Provide to HUD documentation of at least three written price quotations showing justification for the \$99,900 in unsupported costs incurred for electrical wiring upgrades at 15 housing units. This documentation should include a tabulation of quotations received, certified, and retained by the Authority that supports its justification for incurring \$99,900 in expenses. Otherwise, the Authority should repay HUD \$99,900 from non-Federal funds for the unsupported payments.
- 1B. Conduct all future procurements in full compliance with HUD laws and regulations to ensure fair and open competition. If the Authority does so, it will avoid instances such as the roofing and solar panel installation contracts identified in this report that were conducted with limited competition.
- 1C. Establish a record-keeping system that ensures complete, consistent, and accurate documentation of all future procurements to ensure compliance with HUD laws and regulations.
- 1D. Provide appropriate training to responsible personnel to ensure better understanding of HUD procurement laws and regulations.

SCOPE AND METHODOLOGY

We performed our onsite audit work at the Authority, located in Salinas, CA, from February to March 2011. Our audit generally covered the period October 1, 2008, through January 31, 2011.

To complete our objective, we

- Reviewed applicable HUD laws, regulations, and guidance;
- Obtained relevant background information pertaining to the Authority;
- Reviewed Authority policies and procedures related to procurement, monitoring, and reporting of Recovery Act funds, expenditures, and disbursements;
- Interviewed relevant Authority personnel, HUD personnel, and vendors;
- Reviewed relevant Authority monitoring and reporting records, financial records, and procurement records;
- Selected three contractors awarded five grant-funded contracts that exceeded \$100,000. This amounted to more than \$2 million of the more than \$2.9 million in grant funds awarded to the Authority; and
- Conducted onsite reviews of housing developments and units where procured construction work was provided to the Authority.

We conducted the audit in accordance with the 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 finding and conclusion based on our objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective.

INTERNAL CONTROLS

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

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

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

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

- Effectiveness and efficiency of operations - Policies and procedures that were implemented to reasonably ensure that procurement activities were conducted in accordance with applicable laws and regulations.
- Reliability of financial reporting - Policies and procedures that were implemented to reasonably ensure that program funds were monitored and reported in accordance with applicable laws and regulations.
- Compliance with applicable laws and regulations - Policies and procedures that were implemented to reasonably ensure that payments made to vendors and procurement activities complied with applicable laws and regulations.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiencies

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

- The Authority did not ensure compliance with applicable laws and regulations concerning the record keeping of procurements and documentation to support payments for electrical wiring upgrades at 15 housing units using grant funds (finding 1).
- The Authority did not ensure compliance with applicable laws and regulations when it included geographic preference clauses that did not ensure fair and open competition for procurements of its grant-funded roofing construction and solar panels installation contracts (finding 1).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

Recommendation number	Unsupported <u>1/</u>
1A	\$99,900

- 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 the 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

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

July 14, 2011

Tanya E. Schulze
Regional Inspector General for Audit
U.S. Department of Housing and Urban Development
Office of Inspector General
Region IX
611 West Sixth Street, Suite 1160
Los Angeles, California 90017-3101

Dear Ms. Schulze:

Thank you for the opportunity to comment on the draft audit report included with your letter of July 7, 2011. It is always the goal of our Authority to conduct our business in accordance with regulations and in the best interest of the clients we serve. While we feel that we generally meet these goals, we do appreciate feedback on how we can improve our performance.

We would like to offer the following comments with respect to the Recommendations:

OIG Recommendation 1 – Provide to HUD documentation of at least three written price quotations showing justification for the \$99,900 in unsupported costs incurred for electrical wiring upgrades. This documentation should include a tabulation of quotations received, certified, and retained by the Authority. Otherwise, the Authority should repay HUD \$99,900 from non-Federal funds for the unsupported payments incurred.

Authority comments – background

With respect to the finding that the 15-unit electrical wiring upgrade contract was not properly procured, we solicited three quotes and received two bids. One bid was \$10,394 and another bid was for \$12,000 per unit; one bidder chose not to bid. Contractors were requested to come to a job walk. Two showed up and one did not. The “no show” was documented in the file.

Comment 1

We elected to award two units to retrofit in order to provide us with adequate understanding of the scope of work. After completion of the work on the two units, we asked the contractor to revisit his unit price based upon his experience with the first two units. The Contractor dropped his price down to \$6,660 per unit, a 36% savings from the original quote. Given that we had previously received competitive quotes we did not feel it was necessary to go out for another per unit quote again especially given that we did not have the capacity or knowledge to develop a detailed scope of work by unit to provide to potential respondents. Keep in mind that the majority of the work necessary was behind the walls and extensive deconstruction would have been necessary in each unit to adequately define each units' scope of work as all the previous wiring was not done the same and different configurations existed in many units. Deconstruction would have required total tenant displacement due to the existence of asbestos and lead based paint.

When this matter was being considered, staff had a meeting with Authority management (to include the then Executive Director), wherein we discussed how to proceed. Staff and the Executive Director agreed that this was in the best interest of the Authority to accept the lower revised number and to have the work completed to eliminate the safety issue relative to wire melt down that had been occurring at the site over time. We also had experienced a fire at another development (not public housing) where this same situation existed (aluminum wiring) and we wished to avoid any potential injury to tenants. Section II of our policy "Procurement Authority and Administration", B(6), allows for..."contract award is made to the offeror whose proposal offers the greatest value to the Authority, considering price, technical, and other factors...". A 36% savings would constitute the greatest value to the Authority. Your finding states that "the Authority is unable to provide documentation showing the former executive director's decisions". While our documentation of the staff meeting was not retrievable, the very existence of the Executive Director's signature on the contract should validate that this was his decision.

Authority comments – summary

The Authority viewed this as a single procurement action, which occurred in two phases. It is now clear to the Authority that the OIG viewed this as two separate procurement actions because there were two contracts and as a result viewed the second action for the 15-units as having occurred without a procurement action. While the Authority feels that it acted in the best interests of ARRA (expediting the expenditures and saving 36% off of the original per unit quote) and in the best interests of the tenants (repairing the wiring quickly), the Authority will repay the \$99,900 from non-Federal funds and will be more diligent in the future to avoid this situation.

OIG Recommendation #2 – Conduct all future procurements in compliance with HUD laws and regulations to ensure fair and open competition. If the Authority does so, it will avoid instances such as the roof and solar panel installation contracts identified in this report that were conducted with limited competition.

Authority comments – background

Roofing Construction Contract:

The evaluation of the bids and proposals for the roofing construction procurement did not include a geographic preference when considering award. Award was based solely upon lowest most responsive bid. Please reference our bid tabulation form (Check List for Bid Opening April 30, 2009). There are no entries that would indicate a preference in the selection process.

There were 13 bidders on our bidder’s list as well as advertising at five plan rooms (Salinas, San Luis Obispo, Central Coast, Fresno and Sacramento). There were nine local bidders and four bidders out of the area. At no time during the RFP process did any bidder indicate any concern about the contract clause requiring a youth employment hire. The requirement was 2 youth for three months. The total duration of the project was 6 months. It is our experience that most contractors from out of the area will augment their workforce with local hires during the course of construction.

Your finding states that “... the Authority prevented the procurement from being conducted in a manner that was fair and open to competition”. We received five bids on this project. Four responses were local and one was from Clovis, California (150 miles away from the project site). The low bidder was not local.

If the youth hire requirement had created an impediment to bidding, why would prospective bidders not bring it up during the RFP process?

The HUD mandated Section 3 program requires that recipients of certain HUD financial assistance, to the greatest extent possible, provide job training, employment, and contract opportunities for low- or very-low income residents in connection with projects and activities in their neighborhoods. The very term “neighborhoods” implies “local”. Our youth new hire requirement is very much aligned with the Section 3 program. The only exception is that we focused on one of our serious community issues which is gang affiliation by helping teens learn a trade.

Solar Panels

The evaluation of the bids and proposals for the procurement related to the solar panels did not include a geographic preference when considering award. Award was based solely upon lowest most responsive bid. Please reference our bid tabulation form (Check List for Bid Opening July 27, 2009). There are no entries that would indicate a preference in the selection process.

There were 31 bidders on our bidder's list. Two were local bidders (Carmel Valley and Hollister). At no time during the RFP process did any bidder indicate any concern about the contract clause requiring a 50% local hire. The clause states "Contractor shall hire at least 50% of the required work force from available labor". If the contract did not "require" additional labor, other than their existing workforce, then no 50% hire clause would impact the prospective bidder. It is our experience that most contractors from out of the area will augment their workforce with local hires during the course of construction.

Your finding states that "... the Authority prevented the procurement from being conducted in a manner that was fair and open to competition". We received three bids on this project. Two were local and one was from Loomis, California (200 miles away from the project site). The low bidder was not local.

In our opinion, the largest impact to respondents to this RFP was their lack of surety bonding lines, not a local hire requirement. This is demonstrated by the two local respondents, both of whom used "bid bond alternative," either a cash escrow arrangement for the bid bond requirement and the other joint ventured with a General Contractor in order to submit a bid. If the local hire requirement had created an impediment to bidding, why would prospective bidders not bring it up during the RFP process?

The HUD mandated Section 3 program requires that recipients of certain HUD financial assistance, to the greatest extent possible, provide job training, employment, and contract opportunities for low- or very-low income residents in connection with projects and activities in their neighborhoods. The very term "neighborhoods" implies "local". Our local new hire requirement is very much aligned with the Section 3 program. The only exception is that we quantified a 50% goal.

Authority comments – summary

It was the intention of the Authority to further promote Section 3 compliance and to stimulate the local economy in accordance with the goals of ARRA. There was no intention to provide a geographic preference. The Authority now understands the OIG position that the language used in the contract was not consistent with our intentions. This language will not be included in future contracts.

OIG Recommendation #3 – Establish a record-keeping system that ensures complete, consistent, and accurate documentation of all future procurements to ensure compliance with HUD laws and regulations.

Authority comments – background

After discussion with OIG, the Authority understands that this recommendation is related primarily to the situation referenced in Recommendation #1.

Authority comments – summary

The Authority does have a system of record-keeping in place. This recommendation was primarily related to a misunderstanding with regard to whether the electrical wiring procurement action was one action or two. As noted above, we now understand that the OIG views this as two procurements. The Authority will be more diligent in the future. In addition, for consistency in its file documentation, the Authority has also implemented the use of a form to be used in obtaining small purchase bids.

OIG Recommendation #4 – Provide appropriate training to responsible personnel to ensure better understanding of HUD procurement laws and regulations.

The Authority offers training to staff whenever it is available and economically feasible. For instance, during the past year several staff attended procurement and Section 3 training. Unfortunately at least one of those key individuals has left the Authority. The Authority would be happy to accept any technical assistance and/or training that HUD might be able to provide.

The Authority wishes to thank the HUD OIG staff for their guidance and assistance, as well as the professionalism demonstrated by their staff.

Sincerely,

Jean Goebel
Acting Executive Director

OIG Evaluation of Auditee Comments

Comment 1 We acknowledge the Authority's agreement with the finding and efforts to implement corrective action. We appreciate the time and resources devoted to addressing the deficiencies noted in our report.

Appendix C

CRITERIA

The following sections of HUD laws and regulations and Authority procurement policies and procedures were relevant to our audit of the Authority's administration of grant funds.

24 CFR 85.36(b)(9) states that the Authority "will maintain records sufficient to detail the significant history of a 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."

24 CFR 85.36(c)(2) states that the Authority "will conduct procurements in a manner that prohibits the use of statutorily or administratively imposed in-State or local geographical preferences in the evaluation of bids or proposals, except in those cases where applicable Federal statutes expressly mandate or encourage geographic preference."

24 CFR 85.36(d)(1) states that "small purchase procedures are those relatively simple and informal procurement methods for securing services, supplies, or other property that do not cost more than the simplified acquisition threshold fixed at 41 U.S.C. [United States Code] 403(11) (currently set at \$100,000). If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources."

Authority Procurement Policies and Procedures, effective January 25, 2010, (II)(A)(3)(c)(i), states that for small purchases and contracts between \$10,000 and \$100,000, "the Executive Director or a representative, delegated by the Executive Director in writing, shall solicit written price quotations from at least three suppliers. A tabulation of quotations received and certified by the responsible party shall be retained in the purchasing files."