



# Municipality of Toa Alta, PR

## Section 108 Loan Guarantee Program



**To:** Olga De La Rosa, Acting Director, Community Planning and Development, San Juan Field Office, 4ND

**From:** //signed//  
Nikita N. Irons, Regional Inspector General for Audit, 4AGA

**Subject:** The Municipality of Toa Alta, PR, Did Not Properly Administer Its Section 108 Loan Guarantee Program

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Municipality of Toa Alta's Section 108 Loan Guarantee program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.



**Audit Report Number: 2016-AT-1002**

**Date: December 17, 2015**

**The Municipality of Toa Alta, PR, Did Not Properly Administer Its Section 108 Loan Guarantee Program**

## Highlights

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### What We Audited and Why

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We audited the Municipality of Toa Alta's Section 108 Loan Guarantee program. This audit was the result of a referral from the San Juan Office of Community Planning and Development. The objectives of the audit were to determine whether program funds were effectively used to meet a Community Development Block Grant (CDBG) program national objective and provide the intended benefits and whether the Municipality complied with loan application, contract and U.S. Department of Housing and Urban Development (HUD) requirements.

### What We Found

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The Municipality did not ensure that it completed two Section 108 Loan Guarantee activities that showed signs of slow progress. As a result, HUD had no assurance that more than \$9.5 million disbursed for two Section 108-funded activities met a national objective of the CDBG program and fully provided the intended benefits.

The Municipality used more than \$139,000 for ineligible expenditures and did not support the eligibility of \$12,000 in program disbursements. In addition, it did not comply with environmental requirements, disburse loan proceeds within the loan agreement timeframe, provide HUD the required loan collateral, establish a financial management system in accordance with HUD requirements, and ensure that deposits were fully collateralized. As a result, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for authorized purposes and in accordance with HUD requirements.

### What We Recommend

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We recommend that HUD (1) determine the eligibility of more than \$9.5 million in unsupported Section 108 program costs and activities that showed signs of slow progress, (2) require the repayment of more than \$139,000 in ineligible expenditures, and (3) obtain supporting documentation showing compliance with environmental requirements.

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# Background and Objectives

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The Section 108 Loan Guarantee program is the loan guarantee provision of the Community Development Block Grant (CDBG) program. Section 108 loans provide grantees with a source of financing for economic development, housing rehabilitation, public facilities, and large-scale physical development projects. The principal security for the loan guarantee is a pledge by the grantee or the State of current and future CDBG funds. Section 108 obligations are financed through underwritten public offerings and may be for terms of up to 20 years. An entitlement public entity may apply for up to five times the latest approved CDBG amount.

The CDBG rules and requirements apply in determining project and activity eligibility. All projects and activities must meet one of the following three national objectives of the CDBG program: (1) principally benefit low- and moderate-income persons (2) assist in eliminating or preventing slums and blight, or (3) assist with community development needs having a particular urgency.

The Municipality of Toa Alta was founded in 1751, and its governing system consists of an executive and legislative body: a mayor and 14 members of the municipal legislature elected to 4-year terms. The Municipality is an entitlement recipient, which has administered more than \$5.7 million in CDBG funds approved by the U.S. Department of Housing and Urban Development (HUD) during the last 5 years. On September 27, 2007, HUD approved a \$7.88 million Section 108 loan to the Municipality for the development of a multipurpose facility and a municipal cemetery project. The CDBG national objective and intended benefit of the projects was to benefit low and moderate income families.

We audited the Municipality's Section 108 program as part of the HUD Office of Inspector General's (OIG) strategic plan. This audit was the result of a referral from the San Juan Office of Community Planning and Development. The Municipality's Federal Programs Office is responsible for administering the Section 108 program. Its books and records are maintained at Muñoz Rivera Street, Toa Alta, PR.

The objectives of the audit were to determine whether Section 108 Loan Guarantee program funds were effectively used to meet a CDBG program national objective and provided the intended benefits and whether the Municipality complied with loan application, contract, and HUD requirements.

# Results of Audit

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## **Finding 1: Section 108 Loan Guarantee-Funded Activities Did Not Meet Program Objectives**

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The Municipality did not ensure that it completed two Section 108 Loan Guarantee activities that showed signs of slow progress. This deficiency occurred because the Municipality did not properly administer its Section 108 loan activities. As a result, HUD had no assurance that more than \$9.5 million disbursed for two Section 108-funded activities met a national objective of the CDBG program and fully provided the intended benefits.

### **Slow Progress Activities**

More than \$9 million was invested for two activities that reflected slow progress without assurance that the activities would provide the intended benefits. According to Municipality records, the CDBG national objective for these two projects was to benefit low-moderate income persons through area benefit.

Multipurpose facility project - In September 2007, HUD approved the use of \$6.2 million in Section 108 loan proceeds for the development of a four-story multipurpose building, which included parking facilities, a public transportation terminal, and other facilities. According to the loan agreement, all loan proceeds had to be withdrawn and disbursed by June 1, 2010.

The Municipality's planning director informed us that construction of the multipurpose facility was suspended in February 2015 because of a dispute with the contractor and that completion of the project would require additional funding, which the Municipality did not have. We performed a site inspection of the multipurpose project in July 2015 and confirmed that the project had not been completed. At the time of our inspection, the project site looked abandoned and the structure had five levels instead of four as stated in the HUD-approved loan application. Regulations at 24 CFR 570.704(c)(5) provide that grantees must obtain HUD approval to substantially change the purpose, scope, location, or beneficiaries of an activity. The Municipality did not provide documentation showing that HUD approved the change in scope of the project.



The pictures above show that the multipurpose facility site was abandoned.

More than 7 years had elapsed since the Municipality received the Section 108 funds for the activity, and the intended benefits had not been provided. Based on this condition, HUD had no assurance that the multipurpose facility project would fully meet CDBG program objectives and provide the intended benefits. Therefore more than \$8.2 million in Section 108 and CDBG funds disbursed on the project was unsupported.<sup>1</sup>

Municipal cemetery project - In September 2007 HUD approved the use of \$1.66 million in Section 108 loan proceeds for the construction of a municipal cemetery and mausoleum on approximately 18 acres of land owned by the Municipality.<sup>2</sup> According to the loan agreement, all loan proceeds had to be withdrawn and disbursed by June 1, 2010.

The Municipality's planning director informed us that construction of the cemetery project had not started because of a dispute with the contractor and problems with accessing the project site. We performed a site inspection of the cemetery project in July 2015 and confirmed that the project had not started and the property looked abandoned.

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<sup>1</sup> The \$8.2 million invested in the activity consisted of \$6 million in Section 108 loan payments plus \$2.2 million in CDBG funds used for property acquisition and loan repayments.

<sup>2</sup> The Municipality disbursed \$450,700 in CDBG funds to acquire the property.



The picture above shows the municipal cemetery project site. The property was acquired in 2000,<sup>2</sup> and the site was abandoned.

More than 7 years had elapsed since the Municipality received the Section 108 funds for the activity, and the intended benefits had not been provided. Based on this condition, HUD had no assurance that the cemetery project would fully meet CDBG program objectives and provide the intended benefits. Therefore more than \$1.4 million in Section 108 and CDBG funds disbursed in the project was unsupported.<sup>3</sup>

### **Inadequate Administration of Projects**

The Municipality did not properly manage its Section 108 Loan Guarantee program to ensure compliance with program requirements. Section 108-funded activities were not completed in a timely manner and did not provide the intended benefits, the scope of an activity was changed without HUD approval, and there were no written policies detailing procedures and responsibilities related to program administration. The Municipality did not ensure that its Section 108 loan program was administered in accordance with all program requirements.

### **Conclusion**

The deficiencies discussed above occurred because the Municipality did not properly administer its Section 108 program to ensure that its activities met CDBG program objectives. As a result, HUD had no assurance that more than \$9.5 million invested in the Section 108-funded activities met a national objective of the CDBG program and fully provided the intended benefits.

### **Recommendations**

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

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<sup>3</sup> The \$1.4 million invested in the activity consisted of \$449,562 in Section 108 loan payments plus \$1 million in CDBG funds used for land acquisition and loan repayment.

- 1A. Submit a plan for how it will proceed with respect to the multipurpose facility project, including a schedule that HUD can track to ensure its completion. HUD must reevaluate the feasibility of the activity and determine the eligibility of the \$8,111,304 already invested.<sup>4</sup> If HUD determines that the activity has been canceled or is not feasible, the Municipality must commit any unused loan proceeds for future loan repayments.
- 1B. Submit a plan for how it will proceed with respect to the municipal cemetery project, including a schedule that HUD can track to ensure its completion. HUD must reevaluate the feasibility of the activity and determine the eligibility of the \$1,454,801 already invested. If HUD determines that the activity has been canceled or is not feasible, the Municipality must commit any unused loan proceeds for future loan repayments.

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<sup>4</sup> Total investments of \$8,232,388 were adjusted to account for \$109,084 questioned in recommendation 2A and \$12,000 in recommendation 2B.

## **Finding 2: Loan Agreement Provisions and HUD Requirements Were Not Followed**

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The Municipality used more than \$139,000 for ineligible expenditures and did not support the eligibility of \$12,000 in program disbursements. In addition, it did not comply with environmental requirements, disburse loan proceeds within the loan agreement timeframe, provide HUD the required loan collateral, establish a financial management system in accordance with HUD requirements, and ensure that deposits were fully collateralized. These deficiencies occurred because the Municipality's employees were not properly trained and lacked sufficient knowledge of HUD's Section 108 Loan Guarantee program requirements. As a result, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for authorized purposes and in accordance with HUD requirements.

### **Program Disbursements Not Related to Approved Projects**

Contrary to the loan agreement, more than \$139,000 in Section 108 loan proceeds was disbursed to pay for expenditures that were not related to the approved Section 108 projects or were used as a source of temporary financing to the Municipality. Therefore, the Section 108 Loan Guarantee program was charged unnecessary costs that did not meet program objectives.

The Municipality improperly disbursed \$139,290 in Section 108 funds for costs related to retainage fees paid for the public transportation terminal construction that was funded by the Federal Transit Administration, the Municipality's consolidated plan, and housing rehabilitation efforts. In addition, it improperly transferred \$33,933<sup>5</sup> in Section 108 loan proceeds to the general fund account. Paragraph 1(a) of the loan agreement provided that funds could be withdrawn from the guarantee loan funds account only for the payment of the costs of approved Section 108 activity, transfer to the loan repayment account, or the temporary investment of funds under the contract. Regulations at 2 CFR (Code of Federal Regulations) Part 225, appendix A, section C.3.c, specify that any cost allocable to a particular Federal award or cost objective may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. Appendix C provides details of the ineligible disbursements.

### **Program Expenditure Eligibility Not Substantiated**

The Municipality did not properly support the reasonableness and allowability of \$12,000 in disbursed Section 108 funds associated with construction permit fees for the multipurpose facility project. Regulations at 2 CFR Part 225, appendix A, section C.1.b, provide that to be allowable under Federal awards, costs must be necessary, reasonable, and adequately documented. Since proper supporting documentation was not provided, HUD lacked assurance that funds were used for authorized purposes and in accordance with HUD requirements.

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<sup>5</sup> The Municipality's records showed that it had returned most of the funds to its guarantee loan funds account but owed \$476.

### **Environmental Compliance Not Substantiated**

The Municipality disbursed more than \$6.4 million in Section 108 funds for two activities that did not have a proper environmental review or the reviews were not adequately supported. It did not maintain a written record of the environmental review undertaken for each funded Section 108 project and did not provide proof that HUD approved the corresponding request for release of funds. Regulations at 24 CFR Part 58.2(a)(7)(i) and 58.4(a) specify that recipients of HUD assistance are responsible for conducting an environmental review for a particular project or activity and obtaining approval of a request for release of funds. Regulations at 24 CFR 58.22 also specify that a recipient may not commit HUD assistance for an activity or project until HUD has approved the request for release of funds and the related certification. HUD lacked assurance that there had been no commitment of funds or commencement of physical development activities before the approval for release of funds and that the projects did not have an adverse environmental impact.

### **Unexpended Section 108 Loan Proceeds**

The Municipality did not spend loan proceeds before the loan agreement deadline. The agreement for the Section 108 Loan Guarantee assistance, paragraph 1(a), required that all of the loan funds be withdrawn and disbursed by the borrower for the approved activities by June 1, 2010. Any funds remaining after the deadline were to be transferred to an established loan repayment account. Despite this requirement, as of June 30, 2015, the Municipality maintained in its bank account unused Section 108 loan proceeds totaling more than \$1.4 million. The Municipality informed us that it was not aware of the disbursement deadline.

HUD informed us that the Municipality should make the transfer to the repayment account unless the funds were still needed to carry out the approved activity. The Municipality should either transfer the unexpended funds to the repayment account or submit a request for extension to HUD. The Municipality did not transfer the unused funds to the repayment account and did not provide evidence that it had requested an extension from HUD.

### **Loan Collateral Not Provided in Accordance With Loan Agreement**

The Municipality did not provide HUD with additional security to assure the repayment of the debt obligation as required in paragraph 15 of the loan agreement. As a condition for receiving Loan Guarantee assistance, the Municipality was required to submit additional security in the form of a sole first priority lien of real property on or before June 19, 2008. However, the liens on identified properties were more than 7 years overdue and had not been filed. As a result, HUD was at risk of not being able to exercise appropriate remedies in the event of a borrower's defaulting on the Section 108 loan.

### **Inadequate Accounting Records**

The accounting records for the Section 108 Loan Guarantee program did not reflect complete and accurate financial information on program activities. Regulations at 24 CFR 85.20(b)<sup>6</sup> requires recipients of Federal awards to maintain financial records that are accurate, current, and

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<sup>6</sup> The Office of Management and Budget issued final guidance on uniform administrative requirements on December 26, 2013. The cited regulations have since been moved to 2 CFR 200.302.

complete. The records maintained did not properly account for program income, accounts receivable, and capital assets. The Municipality did not maintain a general ledger for the Section 108 program. The accounting record maintained was a check register that contained incorrect balances and transactions that were not recorded. As a result, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for eligible purposes.

### **Deposits Not Fully Collateralized With Government Obligations**

The Municipality maintained deposits of more than \$1.4 million in Section 108 loan proceeds at a local commercial bank without ensuring that they were fully collateralized with Government obligations. Paragraph 1(a) of the loan agreement provided that any amount of Section 108 loan proceeds deposited into a bank and in excess of the Federal deposit insurance limit must be fully invested in Government obligations.<sup>7</sup> However, the Municipality did not provide evidence that these deposits were fully collateralized with Government obligations. As a result, HUD had no assurance that Federal funds were properly safeguarded.

### **Unfamiliarity With Program Requirements**

HUD regulations at 24 CFR 570.501(b) provide that the Municipality is responsible for ensuring that its Section 108 program funds are used in accordance with all program requirements and for taking appropriate action when performance problems arise. The Municipality did not properly manage activities to ensure compliance with Section 108 program requirements. Municipality employees informed us that some of the deficiencies found could be attributed to their unfamiliarity with HUD requirements and that they had not been trained on program requirements. The Municipality's unfamiliarity with program requirements compromised the objectives and effectiveness of the Section 108 Loan Guarantee program.

### **Conclusion**

The deficiencies described above occurred because the Municipality was unfamiliar with program requirements. As a result, HUD lacked 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 instruct the Municipality to

- 2A. Reimburse \$139,767 to its loan guarantee account from non-Federal funds for ineligible disbursements that were not related to the approved projects.

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<sup>7</sup> The Federal insurance amount is currently limited to \$250,000. Government obligations are defined as a direct obligation of or any obligation for which the full and timely payment of principal and interest is guaranteed by the United States of America, including but not limited to United States Treasury certificates of indebtedness and notes and bonds – State and local government series, or certificates of ownership of the principal of or interest on direct obligations of or obligations unconditionally guaranteed by the United States of America, which are held in trust by a commercial bank that is a member of the Federal Reserve System and has capital and surplus in excess of \$100 million.

- 2B. Submit supporting documentation showing the eligibility and propriety of \$12,000 disbursed for construction permit fees or reimburse its loan guarantee account from non-Federal funds.
- 2C. Provide supporting documentation showing that it complied with all environmental requirements. If the Municipality does not provide evidence that it complied with all environmental requirements, HUD must initiate appropriate sanctions under 24 CFR 58.77(d)(1)(v) for noncompliance.
- 2D. Either transfer the unexpended Section 108 loan proceeds to the repayment account or submit a request for extension to HUD.
- 2E. Provide HUD the additional security requirements according to the loan agreement.
- 2F. Develop and implement a financial management system in accordance with HUD requirements to ensure that program funds can be traced to a level, which ensures that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.
- 2G. Ensure that all Section 108 loan proceeds deposited at commercial banks are properly collateralized with Government obligations.

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

- 2H. Provide training, technical assistance, and increase monitoring of the Municipality's performance in the administration of its Section 108 loan program.

# Scope and Methodology

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The objectives of the audit were to determine whether the Municipality effectively used Section 108 Loan Guarantee funds to meet a CDBG program national objective, and complied with loan application and contract requirements, applicable laws and regulations, and HUD policies and directives.

To accomplish our objectives, we

- Reviewed applicable laws, regulations, and relevant HUD program requirements, including the Section 108 loan contracts;
- Reviewed HUD Section 108 loan-related files, including the application for the loan, status reports, and disbursement information reported on loan proceeds and CDBG funds;
- Reviewed the Municipality's project files and records;
- Reviewed HUD's Integrated Disbursement and Information System reports;
- Conducted site inspections of the projects; and
- Interviewed HUD and Municipality officials.

On September 27, 2007, HUD approved a \$7.88 million Section 108 loan to the Municipality. We reviewed the loan to determine whether the loan proceeds were used in accordance with the application and loan agreement and whether activities provided the intended benefits.

The Municipality records reflected that more than \$6.5 million in Section 108 loan proceeds and program income was disbursed between June 2008 and June 2015. We reviewed all 95 disbursements to determine whether funds were used for supported and eligible efforts. In addition, we reviewed \$3.2 million in CDBG funds disbursed for land acquisition and loan repayment associated with the Section 108 activities. To achieve our audit objectives, we relied in part on computer-processed data contained in HUD's information system. 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 adequate for our purposes. We also relied in part on computer-processed data provided by the Municipality. Although the data were not used to materially support our audit findings, conclusions, and recommendations, we performed a minimal level of testing and found the data adequate for our purposes.

The audit generally covered the period September 27, 2007, through August 1, 2015. We conducted our fieldwork from June through October 2015 at the Municipality's office in Toa Alta, PR.

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

# Internal Controls

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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 objectives:

- Program operations – Policies and procedures that management has implemented to provide reasonable assurance that a program meets its objectives, while considering cost effectiveness and efficiency.
- Relevance and reliability of information – Policies and procedures that management has implemented to reasonably ensure that operational and financial information used for decision making and reporting externally is relevant, reliable, and fairly disclosed in reports.
- Compliance with laws and regulations – Policies and procedures that management has implemented to reasonably ensure that program implementation is consistent with laws and regulations.
- Safeguarding of assets – Policies and procedures that management has implemented to reasonably prevent and promptly detect unauthorized acquisition, use, or disposition of assets and resources.

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 Municipality did not implement adequate procedures to ensure that activities provided the intended benefits and met a national objective of the CDBG program (see finding 1).
- The Municipality did not implement adequate procedures to ensure that it complied with loan agreement provisions and regulations (see finding 2).

# Appendixes

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## Appendix A

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**Schedule of Questioned Costs**

<b>Recommendation number</b>	<b>Ineligible 1/</b>	<b>Unsupported 2/</b>
1A		\$8,111,304
1B		1,454,801
2A	\$139,767	
2B		12,000
<b>Totals</b>	<b>\$139,767</b>	<b>\$9,578,105</b>

- 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 policies 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 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

#### Comment 1



Estado Libre Asociado de Puerto Rico  
Gobierno de la Ciudad Autónoma de Toa Alta

CLEMENTE "CHITO" AGOSTO LUGARDO  
ALCALDE DE LA CIUDAD

November 25, 2015

Mr. Nikita N. Irons  
Regional Inspector General for Audit  
75 Spring Street SW,  
Room 330  
Atlanta, GA 30303

Ms. Olga De La Rosa  
Acting Director  
Community Planning and Development  
HUD's San Juan Field Office, 4ND

Re: Exit Conference held on 11/4/15  
Draft audit report of the  
Municipality of Toa Alta's Section 108 Guarantee Program

Dear Mr. Irons and Ms. De La Rosa:

**Municipality of Toa Alta's written comments regarding HUD's draft audit report on the Municipality's Section 108 Loan Guarantee program**

*I. Highlights and background sections*

The draft audit report does not make reference to the fact that, before HUD had announced any audit, the Municipality sent a communication regarding its 108 Loan Guarantee program. Although the Municipality recognizes that this does not affect the audit findings, it is nevertheless important to acknowledge as background information the following: (a) before any audit was announced, the Municipality performed an internal investigation on its 108 Loan Guarantee Program; (b) as a result of said investigation, the Municipality believed some irregularities had been

*Toa Alta se Levanta y Resplandece*

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## Auditee Comments

### Ref to OIG Evaluation

Comment 1

committed; (c) the contractor, inspector and supervisor who had been working on the project were identified as having responsibility regarding the irregularities; (d) the Municipality summarily terminated its contractual relationship with these three parties [REDACTED] which had the effect of paralyzing the construction project; and (e) in further compliance with its fiduciary duty over the public funds invested in the project, the Municipality notified all concerned state and federal agencies (HUD, Commonwealth's Department of Justice, Commonwealth's Comptroller's Office) of its preliminary findings. The letters sent to HUD, the Department of Justice and the Comptroller's Office are herein included as Addendum I for ease of reference.

#### *II. General comment on draft audit report*

As disclosed upfront to HUD's auditor, the Municipality does not have the complete documentation regarding its 108 Guarantee Loan program. This is due to two distinct facts: (a) the records that have been found in the Municipality's Office of Federal programs are incomplete (itself one of the irregularities that prompted the Municipality to notify the concerned agencies, including HUD); and (b) the three private contractors that were summarily dismissed from the construction project upon a finding of irregularities [REDACTED] have all the documentation pertaining to the program, but have deliberately refused to provide it to the Municipality. Although efforts through the Municipality's attorneys are being conducted to compel the delivery or at least the disclosure of the documentation from the three former contractors, those efforts are heavily opposed and thus will take some time until fruition. It should be noted that the construction project cannot be continued without the documentation now in possession of the three former contractors.

Comment 2

In this context, the Municipality asked HUD to directly compel the production of the documents pertaining to the Municipality's 108 Loan Guarantee program that former contractors [REDACTED] possess. This would be the fastest way to obtain the relevant documentation, as HUD has mechanisms to immediately compel production that the Municipality does not have. Thus, the Municipality herein respectfully reinstates its request to HUD that it compel the 108 Guarantee Loan program documents from the former contractors. After such documents are obtained,

Comment 2

## Auditee Comments

### Ref to OIG Evaluation

#### Comment 2

both HUD and the Municipality will be in a better position to assess which program requisites have been complied with and any deficiencies that need to be corrected. Without said documentation, the response and comments that the Municipality can give to HUD's draft audit findings is not fully informed and does not necessarily reflect its position on what really happened. In other words, as HUD's draft audit report relies heavily on the Municipality's inability to provide documentation to prove that the program requisites have been complied with, the lack of access to the documentation in possession of third parties that the Municipality has not had the chance to review provides a formidable obstacle to an adequate response, as well as to the continuation of the construction project.

#### *III. Comments to the Findings of the Audit Report:*

#### **Finding 1- "Section 108 Loan Guarantee-Funded Activity Did Not Meet Program Objectives"**

The Municipality of course recognizes that it is a continuous governmental dependency and thus that any irregularities committed by past municipal administrators is fully attributable to it. However, the fact that there was a change in the Mayor's office in 2013 and that subsequently the Municipality has made all possible efforts to normalize the 108 Guarantee Loan program should be taken into consideration in assessing responsibilities and determining the subsequent steps that should follow.

Upon assuming office in 2013, this Mayor, along with the concerned municipal officers, met with the general contractor, the inspector and the supervisor of the relevant construction project. The Municipality was then assured by these three parties that the delays and costs overrun of this project were a direct result of problems found on the site. They also categorically stated that the problems had been solved and that the project would be finished in a timely basis and within the amended budget.

However, when the pattern of delays and costs overrun continued, the Municipality immediately ordered a complete review of Municipal files related to the construction project. As the identified irregularities pursuant thereto are key to understanding the Municipality's subsequent course of action, a summary of the

## Auditee Comments

### Ref to OIG Evaluation

### Comment 1

most important irregularities found (besides the lack of adequate documentation in the concerned municipal office) is included herewith as Exhibit II.

When informed of the irregularities identified, the Municipality did not extend the contracts with the supervisor and the inspector (that had then recently expired) and proceeded to cancel the general contractor's construction contract. Communications were sent to HUD, the Commonwealth's Department of Justice and the Commonwealth's Comptroller's Office giving notice about the Municipality's preliminary findings.

When the Municipality took control of the site, all pertinent documents such as approved projects working drawings, as-built plans, and similar had been withdrawn from the site. All three parties, the general contractor, the inspector and the supervisor, have refused to return the documents or even to allow their reproduction, claiming that they are owed monies by the Municipality. Thus, the relevant documentation has been held for ransom by these three parties, with the purpose of affecting the Municipality, hiding irregularities, precluding the continuation of the construction project and ultimately forcing the Municipality to pay monies that are not owed. The Municipality has done every possible effort to force the production of these documents; the matter has been referred to the Municipality's legal counsel and is actually in dispute. The Municipality intends to pursue this matter vigorously and to hold all parties accountable for their actions.

Besides its efforts to obtain the relevant documentation directly from the three former subcontractors, the Municipality has requested from the pertinent central office that oversees construction projects in Puerto Rico a copy of its entire file, including approved working documents. These documents have not been received as to this date. Also, the Municipal Legislature approved an Ordinance declaring this situation an emergency that allows the Municipality to proceed with construction without an auction, and interested parties are conducting an as-built analysis in preparation to renew the construction process. However, without the relevant documents, the construction cannot continue.

At this point, with the documentation that it has available and with the caveat that it could vary when the complete documentation is finally received, the

## Auditee Comments

### Ref to OIG Evaluation

### Comment 3

Municipality's position regarding the 108 funded construction at issue is the following: (a) facts seem to indicate that, from the very beginning of the project, there was a collusion between the three contractors that worked on the project [REDACTED] to extend the duration of the project, illicitly cut corners to maximize profit at the expense of the Municipality, commit irregularities and hide the irregularities committed; it is unknown whether the previous municipal administration was involved in this scheme and to what extent; (b) the Municipality has now seized control of the projects from these parties and is positioned to resume construction as soon as the relevant documentation that has been sequestered by the former contractors is obtained; (c) the Municipality is confident that with the funds that have been set aside from the "empréstitos" it will have sufficient funds to complete the projects; (d) the Municipality will vigorously pursue reimbursement from the three former contractors for any irregularities ultimately found; and (e) the Municipality fully concurs with HUD's recommendations to the Director of the San Juan Office of Community Planning and pledges its full cooperation; however, to submit the proposed action plans and to provide an informed position as to the feasibility of the activities and the eligibility of the funds already invested, the Municipality must first obtain the documentation that is in possession of the three former contractors.

#### **Finding 2: "Loan Agreement Provisions and HUD Requirements Were Not Followed"**

As previously stated, the Municipality does not have all documentation pertaining to the construction projects, and thus is not in position to adequately respond to the draft audit findings. However, with the information now available, the Municipality respectfully responds as follows to HUD's specific comments and recommendations at Finding Number 2, with the caveat that review of the documentation that is not available as to this date could change its position and understandings:

- Program disbursements not related to approved projects: the Municipality does not have at present the documentation to refute this finding. However, it is respectfully submitted that there have been substantial expenditures related to the approved projects that were not

### Comment 4

## Auditee Comments

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Comment 4

paid with Section 8 funds but that are allowable. The Municipality very respectfully requests that it be given the opportunity, perhaps through a meeting with HUD personnel, to identify which related expenditures would be acceptable to substitute the monies identified under this finding as non related disbursements.

Comment 5

- Program expenditure eligibility and environmental compliance not substantiated: the Municipality would need to review all documents pertaining to the project, including those in possession of the former subcontractors, to adequately respond.

Comment 6

- Unexpected Section 108 loan proceeds: the Municipality would need to review all documents pertaining to the project, including those in possession of the former subcontractors, to ascertain whether an extension to the deadline was requested and obtained at some point. Regardless, the funds are needed at present to finish the project and thus the Municipality is in full agreement that it must file a request for extension as soon as feasible.

Comment 7

- Loan collateral not provided in accordance to loan agreement: the Municipality has several municipal properties designated to serve as collateral. However, it is correct that the necessary steps to encumber them in favor of the loaner have not been undertaken. The Municipality is in full agreement that this has to be corrected, and at present has given the appropriate instructions to complete the process.

Comment 8

- Inadequate accounting records: the Municipality is in agreement that the records available are inadequate. To remedy said situation, the Municipality has acquired a new accounting program that will allow for proper accounting as required by HUD. The program has been installed and is currently in a data entry/implementation/training phase.
- Deposits not fully collateralized with government obligations: the Municipality is in agreement with this finding and the recommendation to ensure that all Section 108 loan proceeds are properly collateralized

## Auditee Comments

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Comment 9

Comment 9

Comment 10

with Government obligations; Steps to remedy this situation will be immediately commenced.

- Unfamiliarity with program requirements: the Municipality agrees that steps must be undertaken so as to ensure that concerned officers have the necessary knowledge regarding HUD's requirements. The Municipality is already taking action to remedy this situation. There is a newly appointed Director to the Municipality's Federal Relations Office, Mr. Antonio Pérez - Vázquez. The Municipality also has contracted an external advisor on HUD's requirements and commits to procure or provide training on HUD's requirements to the newly appointed director, any subsequent director and relevant personnel, preferably through seminars provided directly by HUD that may be given in the near future. To that end, the Municipality will contact HUD to seek assistance. However, the Municipality does not agree with the conclusion that unfamiliarity with applicable requirements caused performance problems (see below).
- Conclusion: the Municipality respectfully disagrees with the conclusion pertaining to Finding 2. The Municipality contracted three private parties that had the knowledge and expertise to complete the projects at issue and to ensure that all the appropriate proceedings were followed. However, the facts seem to indicate that these three private parties colluded to maximize profit at the expense of the Municipality. The lack of appropriate information and supporting documentation is ultimately attributable to the intentional acts of these parties. Although the Municipality is ultimately responsible to HUD for any irregularities, it took every possible step after identifying such irregularities to adequately discharge its fiduciary duty to the concerned governmental entities, including HUD.
- Recommendations: the Municipality is in agreement with all proposed recommendations pertaining to finding 2. However, as to those requiring that the Municipality provide substantiating or supporting

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Comment 10

documentation, it is absolutely necessary for the Municipality to have access to the documents in possession of the three former contractors in order to comply.

*IV. Final Comment*

The Municipality acknowledges that there have been certain irregularities pertaining to the relevant projects. However, it firmly believes that, in the ultimate analysis, said irregularities are attributable to intentional acts by the contractors hired to execute the construction projects. Certainly, the Municipality's monitoring and accounting could have been better, and that failure to adequately monitor performance provided fertile ground for the contractors to manipulate the facts and information to their unfair advantage. However, upon learning of the irregularities, the Municipality has undertaken vigorous and decisive steps to normalize the relevant projects, correct the irregularities that can be remedied, obtain and tabulate all relevant documentation and hold the concerned private parties fully accountable for their actions. The Municipality is fully committed to follow HUD's requirements and recommendations and to work hand in hand so as to ensure the future completion of the projects at issue.

The Municipality thus proposes that it be given an opportunity to obtain the relevant documentation from the former contractors, either by itself or preferably through HUD's assistance. After said documentation is obtained, the Municipality will be in an adequate and fully informed position to address the concerns raised in HUD's audit draft report, to substantiate that the expenditures made in the projects were allowable, to identify and correct any further irregularities and to submit a viable action plan and proposal to expeditiously finish the pending projects.

Very respectfully submitted,

  
Clemente Agosto Lugardo  
Mayor of the Municipality of Toa Alta

## OIG Evaluation of Auditee Comments

Comment 1 The Municipality stated that the audit report did not make reference to the internal investigation it made on its Section 108 loan program. As a result of this investigation, the Municipality terminated its contractual relationship with three contractors and it provided HUD with the preliminary findings.

We acknowledge efforts taken by the Municipality to ensure that Section 108 funded activities comply with all HUD requirements. However, the HUD San Juan Office does not have any documentation regarding the preliminary findings. The only documentation available in HUD files was a letter dated February 2, 2015, informing that it had detected contracting and construction irregularities and was terminating the contracts. The Municipality must submit the appropriate documentation to HUD in order for HUD to make a determination on the alleged findings.

Comment 2 The Municipality indicated that it did not have complete files pertaining to its Section 108 activities, and that the former contractors possess all pertinent records. In addition, it request HUD to compel the contractors to provide the records, and after receipt the Municipality would be in a better position to evaluate the issues associated with the audit findings.

We do not agree with the Municipality. The resolution to the audit findings and recommendations cannot be conditioned to the release of documents on behalf of former contractors. The Municipality is the sole responsible entity for ensuring that HUD funded activities meet all program requirements and that loan agreement provisions are followed. The Municipality must immediately work with HUD to address the deficiencies cited in the audit report.

Comment 3 The Municipality stated that it agrees with recommendations 1A and 1B. It states that for the Municipality to submit a plan on how it will proceed with respect to the two projects, it must obtain documentation from the former contractors.

The Municipality is responsible for ensuring that Section 108 funded activities meet HUD requirements and that it maintains appropriate documentation. It must submit the appropriate evidence to HUD in order for HUD to make a feasibility determination of the projects. If the Municipality cannot provide appropriate documentation, HUD should consider declaring the loan in default and recuperate from the Municipality all funds invested.

Comment 4 The Municipality indicated that it did not have information to contest the ineligible amount. However, it proposed to substitute the ineligible disbursements with other disbursements that the Municipality considers to be eligible Section 108 program expenditures instead of reimbursing the funds.

The Municipality did not provide additional documentation regarding the proposed substitution of costs. The Municipality must submit appropriate evidence to HUD in order for HUD to make a propriety and feasibility determination.

Comment 5 The Municipality stated that it did not have sufficient documentation to respond to recommendations 2B and 2C. It is the Municipality's responsibility for ensuring compliance with program requirements and that it maintains appropriate documentation.

Comment 6 The Municipality indicated that the unexpended funds are needed to complete the project and that it agreed that an extension request needed to be filed as soon as possible.

Although the Municipality stated that it needed the funds to complete the project, it is not clear on which of the two HUD approved projects it plans to use the funds. Any future disbursements of Section 108 funds should only take place after HUD reevaluates the feasibility of the activities and determines the eligibility of the funds already invested.

Comment 7 The Municipality stated that it will provide HUD the additional security requirements according to the loan agreement. The Municipality must coordinate with HUD to ensure that the appropriate documentation is submitted as soon as possible since the liens on identified properties are more than 7 years overdue.

Comment 8 The Municipality indicated it acquired a new accounting system and that it was currently undergoing the data entry/implementation and training phase. We recommend that the Municipality coordinate with HUD regarding the implementation of this new system to ensure it complies with HUD requirements.

Comment 9 The Municipality stated that it had appointed a new director and that it will take steps to provide adequate training. However, it disagrees with the cited cause in Finding 2, and alleged that the lack of information and documents is attributed to the former contractors.

We commend the Municipality for steps taken to train pertinent program officials. However, we do not agree with the Municipality attributing the deficiencies to external parties. The Municipality is the responsible entity for ensuring that loan agreement provisions and HUD requirements were followed. External contractors cannot be attributed the responsibility for establishing the Municipality's financial management system or the submission to HUD of additional security in the form of a sole first priority lien of real property.

Comment 10 The Municipality indicated that it will need access to the records maintained by the former contractors and request that it be given the opportunity to obtain relevant documentation to address the concerns raised in the audit report and submit an action plan.

The Municipality needs to take all appropriate measures to obtain any documentation it believes is necessary. However, we do not agree that the resolution to the audit findings and recommendations be conditioned on the release of documents on behalf of former contractors. The Municipality must immediately work with HUD to address the deficiencies cited in the audit report or reimburse HUD funds invested in the two projects.

## Appendix C

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### Schedule of Ineligible Disbursements

Date	Check number	Amount	Comment
March 17, 2011	93	\$476	Loan to purchase tires for Municipality vehicle
September 13, 2012	1838	109,084	Project completion retention related to Federal Transit Administration funds
October 24, 2012	94	17,000	Fair housing impediments analysis related to the Municipality's consolidated plan
December 5, 2012	95	7,800	Materials for moderate rehabilitation activity
May 7, 2013	96	3,815	Materials for moderate rehabilitation activity
September 20, 2013	97	1,592	Materials for moderate rehabilitation activity
<b>Totals</b>		<b>\$139,767</b>	