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TO: K.J. Brockington Director, Office of Public Housing, 9DPH
Joan S. Hobbs

FROM: Joan S. Hobbs, Regional Inspector General for Audit, Region IX, 9DGA

SUBJECT: The Housing Authority of the City of Calexico, Calexico, California, Did Not Comply with Public Housing Program Rules and Regulations

HIGHLIGHTS

What We Audited and Why

We audited the Housing Authority of the City of Calexico (Authority) in response to a request from the Office of Inspector General's (OIG) Office of Investigation and the Federal Bureau of Investigation (FBI). Our objective was to determine whether the Authority complied with the U.S. Department of Housing and Urban Development's (HUD) rules and regulations with respect to its public housing program. Specifically, we wanted to determine whether allegations brought forward from the Office of Investigation and the FBI regarding the Authority's improprieties with the 2003 purchase of the 1230 and 1250 Second Street Apartments had merit. We wanted to determine whether the Authority (1) used its public housing and Section 5(h) program funds to pay for unauthorized activities or in a manner consistent with HUD rules, regulations, and Authority policies and procedures; (2) provided replacement housing for the Section 5(h) units it sold; (3) followed proper procurement procedures; (4) made eligible and appropriately supported expenditures; (5) had an effective accounting system; and (6) followed proper procedures with regard to tenant application processing.

What We Found

The Authority improperly used Section 5(h) program funds for the acquisition and operation of the Second Street Apartments. In addition, it (1) did not provide replacement housing for the 37 Section 5(h) units it sold, (2) incorrectly reported three of the six grants reviewed as fully obligated in HUD's electronic Line of Credit Control System, (3) undertook force account activity without HUD's written approval, and (4) undertook five inappropriate procurement actions. The expenses we reviewed were eligible and appropriately supported, no public housing funds were used to pay unauthorized activities, the accounting system was effective, and the Authority followed proper procedures with regard to tenant application processing.

What We Recommend

We recommend that HUD require the Authority to repay Section 5(h) program \$174,044 from nonfederal sources for the inappropriate acquisition and operation of the Second Street Apartments. Additionally, we recommend that HUD require the Authority to create and implement a new timeline for replacement of the Section 5(h) units and if the Authority does not follow this new timeline, recapture the \$1.2 million available in its program bank account as of January 2008. We also recommend that HUD's Los Angeles Office of Public Housing require the Authority to recapture \$247,101 in grant funds that the Authority did not fully obligate by the required deadline for grant years 2001, 2003, and 2005; require the Authority to provide supporting documentation for \$827,756 in unsupported procurement actions or repay HUD from nonfederal sources; and require the Authority to repay HUD \$184,588 from nonfederal sources for ineligible force account labor costs.

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 draft report on May 20, 2008, and held an exit conference with the Authority's officials on May 30, 2008. The Authority provided written comments on June 13, 2008. It partially agreed with our comments in the audit report but had some explanatory comments.

The complete text of the auditee's response, along with our evaluation of that response, can be found in appendix B of this report. The exhibits are too voluminous to include in this report. However, the documents are available upon request.

TABLE OF CONTENTS

Background and Objectives	4
Results of Audit	
Finding 1: The Authority Inappropriately Used \$174,044 in Section 5(h) Program Funds for the Acquisition of the Second Street Apartments	6
Finding 2: The Authority Did Not Provide Replacement Units for Units Sold	8
Finding 3: The Authority Incorrectly Reported Its Grants in the Electronic Line of Credit Control System as Fully Obligated	10
Finding 4: The Authority Undertook a Force Account Activity without HUD's Written Approval	14
Finding 5: The Authority Did Not Follow Federal Requirements for Procurement and Spent \$1,012,344 on Unsupported and Ineligible Costs	16
Scope and Methodology	20
Internal Controls	21
Appendixes	
A. Schedule of Questioned Costs and Funds to Be Put to Better Use	23
B. Auditee Comments and OIG's Evaluation	24
C. Criteria	37

BACKGROUND AND OBJECTIVES

The Housing Authority of the City of Calexico (Authority) was established in 1945 under the Housing Authority Law of the State of California. The Authority entered into its most recent annual contributions contract with the U.S. Department of Housing and Urban Development (HUD) on October 11, 2001. The Authority is governed by a board of commissioners (board) made up of seven individuals who must be appointed. Currently the Authority does not have a permanent executive director. Its last executive director's employment was terminated in August 2007, and the Authority currently has its second interim executive director since the start of this audit.

The Authority currently operates the following programs:

1. Public housing – 265 units; a combination of single-family homes, multiplexes, and a 98-unit apartment building.
2. Housing Choice Voucher program – 244 vouchers.
3. Multifamily – Calexico Gardens; a two-story apartment building with 39 units.

We reviewed the Authority's public housing program; however, our emphasis was on the capital fund program. Specifically, we reviewed the program grants received between 2001 and 2005. The table below shows the grants reviewed.

Capital fund program grants reviewed

Count	Grant number	Grant year	Grant amount
1	CA16P03950101	2001	\$739,301
2	CA16P03950102	2002	\$554,657
3	CA16P03950103	2003	\$544,936
4	CA16P03950203	2003	\$115,097
5	CA16P03950104	2004	\$668,822
6	CA16P03950105	2005	\$578,189
		Total	\$3,201,002

Section 5(h) Program

The Quality Housing and Work Responsibility Act permits public housing agencies, through Section 32 of the United States Housing Act of 1937, to make public housing dwelling units available for purchase by low-income families as their principal residences. Under Section 32, a public housing agency may sell all or a portion of a public housing development to eligible low-income applicants. These applicants may or may not be public housing residents. The Authority participated in this program by selling single-family homes from its Casas del Sol development. As of March 2008, the Authority had sold 37 of the 50 single-family homes in the Casas del Sol development.

Second Street Apartments

The Authority purchased the Second Street Apartments with the intention that they would be the replacement housing for its Section 5(h) program Casas del Sol units that it sold to low-income families. The Second Street Apartments are preexisting buildings located at 1230 Second Street and 1250 Second Street. Each apartment building has two stories. The building at 1230 Second Street contains 17 units, and the building at 1250 Second Street contains 14 units.

The Authority operated the property for eight months before the purchase as though it was an approved public housing project and paid \$168,257 in rents assigned to the former owner during that time. The Authority's board signed a resolution on September 9, 2004, stating that it intended to borrow nearly \$1.7 million from Federal Home Loans at 12.5 percent interest over 120 months with interest-only payments in the amount of \$17,680 per month. The total purchase price was \$2.2 million. During the time the Authority operated these apartments, it paid at least \$380,080 for mortgage and other expenses. The property was sold in 2006 when the Authority did not receive the anticipated tax credits or funding commitment. The sales price of the property was \$2.5 million.

Force Account Labor

Force account labor is defined as "labor employed directly by the PHA [public housing authority] on either a permanent or a temporary basis" by 24 CFR [*Code of Federal Regulations*] 968.105. In this case, the Authority either used maintenance personnel already on the Authority's payroll to perform force account labor or employed individuals from a temporary staffing agency.

Audit Objectives

Our objective was to determine whether the Authority complied with HUD's rules and regulations with respect to its public housing program. More specifically, we wanted to determine whether allegations brought forward from the Office of Inspector General's (OIG) Office of Investigation and the Federal Bureau of Investigation (FBI) regarding the Authority's improprieties with the 2004 purchase of the 1230 and 1250 Second Street Apartments had merit. We wanted to determine whether the Authority (1) used its public housing and Section 5(h) program funds to pay for unauthorized activities or in a manner consistent with HUD rules, regulations, and Authority policies and procedures; (2) provided replacement housing for the Section 5(h) units it sold; (3) followed proper procurement procedures; (4) made eligible and appropriately supported expenditures; (5) had an effective accounting system; and (6) followed proper procedures with regard to tenant application processing.

RESULTS OF AUDIT

Finding 1: The Authority Inappropriately Used \$174,044 in Section 5(h) Program Funds for the Acquisition of the Second Street Apartments

The Authority inappropriately used \$174,044 in Section 5(h) program funds from the sale of the Casas del Sol homes for its purchase of the Second Street Apartments. This condition occurred because its board did not ensure that the Authority obtained the required funding commitment before its purchase and found that it could not afford to operate the project without this funding commitment. Consequently, this inappropriate use diverted funds, which should have been used to provide more affordable housing to the area's low-income population.

The Authority Entered into a Section 5(h) Implementing Agreement

In May 2001, HUD and the Authority entered into a Section 5(h) implementing agreement to participate in the Section 5(h) homeownership program for public housing, which involved selling its Casas del Sol development. The objective of this program was to allow public housing authorities to sell some housing inventory to residents and/or other eligible low-income buyers. A stipulation of this agreement was that the Authority's board would be responsible for implementing the plan and for all phases of any program developed under the plan.

Federal regulations at 24 CFR [*Code of Federal Regulations*] 906.16 state, "as a condition for transfer of ownership under a HUD-approved homeownership plan, the PHA [public housing authority] must obtain a funding commitment, from HUD or another source, for the replacement of each of the dwellings to be sold under the plan." The Authority attempted to replace the units it sold with the purchase of the Second Street Apartments. However, it did not receive approval from HUD for the purchase of these two apartment buildings and did not receive the required funding commitment from HUD or from any other source.

The Authority Used Ineligible Section 5(h) Program Funds

Our review of the purchase of the Second Street Apartments found that the Authority used \$913,035 in Section 5(h) funds from the sales of the Casas del Sol homes for (1) appraisals, (2) part of the downpayment, (3) operating and various other expenses, and (4) repayment to its public housing program, all related to the Second Street Apartments.

To pay the operating expenses of the Second Street Apartments, the Authority obtained funds from the project's operating revenue as well as from Section 5(h) program funds. Soon after the purchase, the Authority began defaulting on its \$17,680 monthly mortgage payments and eventually sold the property. This condition occurred because the Authority's board did not ensure that the Authority obtained the required funding commitment before purchasing the property.

The Authority reimbursed the Section 5(h) account \$543,550 with proceeds received from the sale of the Second Street Apartments; \$64,500 with funds remaining in the Second Street Apartments' bank account once the property had been sold; \$69,906, a reimbursement from its public housing program for an overpayment received; and \$61,035, a reimbursement to its public housing program for Section 5(h) Program consulting expenses. Nonetheless, the purchase and operation of the Second Street Apartments resulted in net ineligible costs to the Authority's Section 5(h) program of \$174,044 (\$913,035 - \$738,991).

Recommendations

We recommend that HUD's Los Angeles Office of Public Housing require the Authority to

- 1A. Repay its Section 5(h) program \$174,044 from nonfederal sources for ineligible expenses.

Finding 2: The Authority Did Not Provide Replacement Units for Units Sold

Between March 2004 and September 2006, the Authority sold 37 units from its Casas del Sol public housing stock and did not provide the required replacement units. We attribute this deficiency to a lack of leadership from the Authority's board, which was responsible for implementing the Authority's Section 5(h) homeownership plan and for all phases of any program developed under the plan. As a result, \$1.2 million is available but restricted in an Authority bank account, while more than 1,000 individuals or families remained on the Authority's waiting lists for housing.

The Authority Planned for Replacement Units

The Authority planned for its purchase of the Second Street Apartments to satisfy its requirement for replacement housing for the Casas del Sol units it sold through its Section 5(h) homeownership program. However, the purchase was not approved by HUD, and when the Authority began defaulting on its loan as the result of not being able to obtain the required funding commitment, it sold the project.

The Authority next planned to build a senior housing complex near the river on an empty lot that it already owned. This land was part of the original Casas del Sol project that the Authority had not developed with single-family units because it thought the property would be a good place for a one-bedroom apartment complex. The Authority had already paid the \$2,500 application fee to have the land rezoned. This process started in 2006 and was completed in July 2007. At its November 8, 2007, board meeting, the Authority discussed building a senior housing project and determined that "the cost to build this development is approximately \$2.5 to \$3 million." It planned to ask HUD to approve the project as replacement housing for units sold under the Casas del Sol development.

In October 2007, the financial director told us that the Authority realized that it had been three years since the first sale in 2004. However, HUD had not given it a timeframe for completing the process. In its draft to HUD of the Section 5(h) homeownership plan, the Authority stated that it should take 10 years to complete, and HUD officials had the Authority take the time limit out of the plan. The financial director also told us that the Authority understood that there was no timeframe for replacement housing completion.

The implementing agreement entered into by HUD and the Authority states that the Authority must obtain HUD approval to modify any of the provisions of the Casas del Sol Section 5(h) plan, and the plan states that sales proceeds shall be obligated in a timely fashion. In addition, in an attachment to its year 2000 plan, the Authority included a

timeline for the entire process. This timeline was approved as part of the plan. The Authority expected the sales process to take six months, ending with the lender approval. However, this process took much longer than expected, with the Authority selling its first house in March 2004 and its 37th house in September 2006, two and one-half years later. In addition, as of March 2008, all the original 50 homes had not been sold.

Although the Authority submitted a revised plan to HUD that was approved in November 2005, the plan no longer had any information regarding the timing of the replacement housing. A timetable is required by 24 [*Code of Federal Regulations*] 906.39(m). The Authority also submitted a letter to HUD on November 8, 2007, stating that it was submitting its proposal application for mixed finance operating subsidy on replacement housing for the Section 5(h) units it had sold. However, it did not attach the proposal as the letter stated and as of April 2008, had not submitted the proposal. Contrary to the requirements of the implementing agreement entered into between the Authority and HUD, the Authority did not obligate the sale proceeds from the Section 5(h) program in a timely manner.

As a result, the Authority's public housing waiting list for one-bedroom units as of January 2007 had 283 names on it. However, since the Authority did not have many one-bedroom units, many of these tenants were put into two-bedroom or three-bedroom units that were available at the time. In addition, there are more than 1,000 individuals or families on the Authority's waiting lists. The Authority's board should have worked with HUD to modify the plan's timeline to adjust for the delays. Therefore, HUD should require the Authority to create and implement a new timeline for the completion of replacement housing. If the Authority fails to meet this timeline, HUD should recapture the sales proceeds collected thus far in accordance with the provisions of the Section 5(h) implementing agreement. This would put funds totaling more than \$1.2 million to better use by either providing replacement housing or having HUD recapture the sales proceeds and reprogram the funds rather than allowing the funds to sit idle in a bank account.

Recommendation

We recommend that HUD's Los Angeles Office of Public Housing

- 2A. Require the Authority to create and implement a new timeline for completing replacement housing and if the Authority does not meet this timeline, with exceptions for delays beyond the control of the Authority, recapture the \$1,210,852 available but restricted in the Section 5(h) program bank account as of January 2008 and put these funds to better use.

Finding 3: The Authority Incorrectly Reported Its Grants in the Electronic Line of Credit Control System as Fully Obligated

The Authority incorrectly reported in HUD's electronic Line of Credit Control System three of the six grants we reviewed as having been fully obligated by the obligation deadline. The deficiency occurred because the Authority did not have policies and procedures in place for processing electronic Line of Credit Control System obligations. We also attribute the deficiency to the late start of the Authority's procurement process. As a result, the Authority received \$247,101 for funding that was not obligated in a timely manner.

Obligations Must Be Made within 24 Months of Receiving Funds

The Quality Housing and Work Responsibility Act of 1998 (Act) states that a public housing agency shall obligate any assistance received under this section not later than 24 months after the date on which the funds become available to the agency for modernization purposes or the date on which the agency accumulates adequate funds to undertake modernization, substantial rehabilitation, or new construction of units. In addition, federal regulations at 24 CFR [*Code of Federal Regulations*] 905.120(b)(3) state that this is material if more than 10 percent remains unobligated after the end of the period (applicable only to fiscal year 2004 and later). Funds are obligated under a grant when a contract is signed or in the case of force account activity, when the first penny is spent on force account labor.

The Act also states that HUD has the right to recapture any obligation entered into by a housing authority for a violation by the housing authority of the requirements of the Act. This would include any failure of the housing authority to obligate funds in a timely manner. Further, HUD's Notice: Public and Indian Housing 2003-19 (Public Housing Authorities) states, "any amounts made available under the public housing Capital Fund for fiscal years 1999, 2000, 2001, 2002, or 2003 that remains unobligated in violation of paragraphs (1) of such section 9(j)... the Secretary shall recapture any such amounts..." This notice also states, "...the Appropriations Act [of 2003] **requires** HUD to recapture any amounts not obligated or expended by the deadline. Since this change is statutory, the Department has no authority to waive the implementation of this provision."

Funds Not Obligated

We reviewed a total of six capital fund program grants received by the Authority to determine whether the funds were properly obligated in a timely manner. We determined that grants received in 2001, 2003, and 2005 were not obligated within the required 24-month timeframe as noted in the table below.

Grant number	Grant amount	Grant year	Obligation year (two years)	Obligation requirements met
CA16P03950101	\$739,301	2001	2003	No
CA16P03950102	\$554,657	2002	2004	Yes
CA16P03950103	\$544,936	2003	2005	No
CA16P03950203	\$115,097	2003	2005	Yes
CA16P03950104	\$668,822	2004	2006	Yes
CA16P03950105	\$578,189	2005	2007	No

2001

In July 2001, the Authority received grant CA16P03950101. It had two contracts for major work planned that were appropriately signed and dated by the obligation deadline of June 30, 2003, using these grant funds. However, for other contracts paid with funding from this grant, the contract date and/or the first force account labor activity expense was dated more than six months after the obligation deadline. Supporting documents showed that at least \$69,310 of this grant was entered into HUD's electronic Line of Credit Control System as fully obligated when it was not.

2003

In September 2003, the Authority received grant CA16P03950103. It had purchase orders and supporting invoices for three of its major work projects that were obligated by the deadline of September 16, 2005. Two of these projects were obligated in August 2005, and the third one was obligated on September 15, 2005, one day before the obligation deadline.

The Authority ultimately spent less than it had budgeted so it started another project from its five-year plan. This is allowable by 24 CFR [*Code of Federal Regulations*] Part 968, subpart C. However, this project used force account labor, and the first expense for the project was dated September 2006, while the obligation deadline was September 2005. Clearly, this project started one year after the obligation deadline; thus, the funds were not truly obligated as the Authority claimed in HUD's electronic Line of Credit Control System. As a result, at least \$134,660 was identified in HUD's system as having been fully obligated when it was not.

2005

In August 2005, the Authority received grant CA16P03950105. As part of the obligations for this grant, the Authority signed a contract for \$329,960 in September 2007, after the obligation deadline. However, it incorrectly reported this grant as having been fully obligated as of August 2007. HUD relies on the accuracy of the information entered by public housing authorities to determine whether funds were obligated on time. The Authority did not run its first advertisement for this contract until June 29, 2007, 22 months after receiving access to the grant funds, giving the Authority less than two months to complete the procurement process. This contract totaled 57 percent of the Authority's total grant funds; therefore, the grant was not 90 percent obligated by the Authority's obligation deadline of August 17, 2007.

Unlike in earlier years, for fiscal year 2005, HUD's Appropriations Act did not require HUD to recapture capital funds that did not meet the obligation deadline. HUD identified an alternative sanction in its Notice: Public and Indian Housing 2005-22 (Public Housing Authorities) which states, "The Act and the regulation provide sanctions for PHAs [public housing authorities] that do not obligate in a timely manner. Specifically, HUD is to withhold a PHA's next Capital Fund grant(s) until the PHA obligates 90 percent of its past due grant. If the PHA cures its failure to comply with the obligation requirement during the year, HUD will release the new Capital Fund grant(s). The penalty for noncompliance will be to reduce the new Capital Fund grant(s) by 1/12 for every month the PHA was in noncompliance." As a result, if HUD had known that the Authority did not obligate at least 90 percent of its grant by the deadline, HUD would have reduced the Authority's next grant funds received in 2007 and authorized a reduction of the \$517,578 by 1/12th, or \$43,131, for the one month that exceeded the 90 percent obligation requirement.

Recommendations

We recommend that HUD's Los Angeles Office of Public Housing

- 3A. Recapture \$247,101 in grant funds from the Authority for funding that was not fully obligated by the required obligation deadline for grant years 2001, 2003, and 2005.
- 3B. Require the Authority to create and implement policies and procedures to ensure that entries into HUD's electronic Line of Credit Control System are correct entries, and obligations are not entered before the funds are actually obligated.
- 3C. Require the Authority to provide copies of executed contracts, regardless of the amount, to the Los Angeles field office as support for all future funds that the Authority obligates.

- 3D. Require the Authority to begin its procurement process in a more timely manner, allowing it more time to complete its procurement process and, thus, more consistently meet its obligation deadlines.

Finding 4: The Authority Undertook a Force Account Activity without HUD's Written Approval

The Authority undertook a force account labor activity without receiving written permission from HUD, as required. It did not obtain HUD's permission because it incorrectly believed it was a high performer and as such, was not required to obtain HUD's permission. As a result, the Authority inappropriately spent at least \$12,830 on force account labor for the installation of air conditioners.

Air Conditioner Installation

24 CFR [*Code of Federal Regulations*] 968.120 states, "a Public Housing Authority may undertake the activities using force account labor, only where specifically approved by HUD in the CIAP [comprehensive improvement assistance program] budget or CGP [comprehensive grant program] Annual Statement, except no prior HUD approval is required where the PHA [public housing agency] is designated as both an overall high performer and Modernization high performer under the PHMAP [public housing management assessment program]." In September 1998, this assessment system was replaced with the public housing assessment system. The new assessment system was effective for all public housing authorities with fiscal years ending on September 30, 1999, and after. One rule of the new assessment system was a requirement that a public housing authority put force account labor (FA) by projects in its annual plan to indicate that the project would be performed with force account labor. This would notify HUD of the housing authority's intentions. However, our review of the Authority's 2001 and 2005 five-year plans covering years 1997-2005 determined that it never made this indication.

The Authority undertook the installation of air conditioners at development 39-9 using force account labor without approval from HUD or being designated as a high performer. The air conditioners cost \$47,472. They were properly procured and purchased in 2005, while the labor was performed in 2006. However, the Authority was not designated as a high performer in 2005 or 2006. Further, although the Authority stated that it asked for the Los Angeles field office's approval to do a force account project and was told that it was a high performer and did not need HUD's permission, it could not document this discussion, which may have occurred during fiscal year 2003 or 2004 when the Authority was designated a high performer. As a result, the Authority spent at least \$64,386 on this project, \$12,830 of which was for force account labor, which HUD cannot be assured was reasonable.

Recommendations

We recommend that HUD's Los Angeles Office of Public Housing require the Authority to

- 4A. Provide supporting documentation to show that \$12,830 was reasonable for force account work or repay HUD for undertaking an unapproved force account labor activity.
- 4B. Obtain written approval from HUD for all future force account projects.

Finding 5: The Authority Did Not Follow Federal Requirements for Procurement and Spent \$1,012,344 on Unsupported and Ineligible Costs

The Authority did not comply with HUD's rules and regulations for procurement. It undertook five separate procurement activities without first preparing the required cost or price analysis. This condition occurred because the Authority either ignored or did not understand federal law and standards identified in 24 CFR [*Code of Federal Regulations*] 85.36 and ignored its own policies for procurement. In addition, the executive director overrode procurement regulations and policies. As a result, the Authority spent \$1,012,344 in capital fund program funding on unsupported or ineligible costs.

Lack of Cost/Price Estimates

Federal regulations at 24 CFR [*Code of Federal Regulations*] 85.36(f)(1) state, "grantees and subgrantees must perform a cost or price analysis in connection with every procurement action," and the Authority's procurement policy states, "a cost or price analysis shall be performed for all procurement actions, including contract modifications." The Authority undertook at least 15 projects that involved either the procurement of materials only or a combination of both materials and labor. Of these 15 projects, five (33-percent) lacked cost or price analyses. The modernization director said that cost or price analyses were always prepared before bids were advertised; however, he was unable to locate the missing cost or price analyses. As of April 2008, he had not provided the missing documentation.

Unsupported Costs

Contract Activities

The Authority procured three major contracts for air conditioning replacement and roofing work. Our review of Authority files showed the first contract was to replace the air conditioning at developments 39-1 and 39-2. There was no cost or price analysis. As a result, the Authority budgeted only \$82,087 but the contract was awarded for \$170,000. The second contract was to replace the air conditioning and roofing at development 39-9. Again, there was no cost or price analysis. As a result, the Authority budgeted only \$167,132, but the contract was awarded for \$360,991. The third contract was to replace the roofing at development 39-2. Again, there was no cost or price analysis. As a result, the Authority budgeted only \$95,000, but the contract was awarded for \$217,000. With all three contracts, the Authority underbudgeted the projects by more than 200 percent. Cost estimates are important because without the price or cost analysis, it is difficult for

the Authority to reasonably budget for projects, and HUD cannot be assured that the Authority received a fair or reasonable price for the materials and labor procured.

Force Account Labor Activities

The Authority undertook two activities in which it used force account labor and did not first prepare cost or price analyses. The first activity was for painting. The Authority advertised bids for painting services and only received one bid, which the Authority felt was too high. It did not know whether this was a fair price since it did not have a cost or price analysis. There were quotes in the file from various vendors for one can of paint but no estimates regarding how many cans of paint, what additional materials, or how much time and labor would be needed. Ultimately, the Authority spent at least \$47,290 on this activity. However, because it did not keep complete records of force account activities, we were unable to determine whether the force account activity included all aspects included in the requests for proposal for painting services or whether the force account services were more cost effective than services provided by a contractor.

The second activity was the replacement of 100 water heaters. The Authority spent \$32,475 on the purchase of the water heaters but did not have any rate quotations. Further, the budget it prepared assumed that the water heaters would cost as much as \$90,000. As shown, rate quotations are important because without them it is difficult to determine whether the Authority paid a fair and reasonable price for the materials it procured or whether it was cost effective for these jobs to be undertaken with force account labor. In addition, in instances in which the Authority did have a cost or price analysis, only one included a date. Thus, HUD had no way to determine whether the estimates were prepared before the procurement as required.

Procurement Procedures Not Used

The Authority undertook a force account labor activity for concrete/exterior work at development 39-3. A review of two folders labeled 39-3/Concrete and 39-3/Concrete July '04 revealed no evidence of bid advertisements or bids received for concrete or exterior work for development 39-3. While this activity was included in the Authority's annual statement/performance and evaluation report, it did not have the force account designation in parenthesis next to it as required. The Authority's procurement policies state "sealed bidding is the preferred method for construction procurement. For procurements under the Capital Fund Program (CFP)/Comprehensive Grant Program (CGP), sealed bidding shall be used for all construction and equipment contracts exceeding the small purchase limitation." However, the executive director abandoned this policy and instructed the modernization director to move forward and undertake the project as a force account labor activity. Overall, this development consisted of 50 units, and the activity cost the Authority at least \$184,588 (\$80,039 for materials and \$104,549 for labor), which is more than 200 percent more than the budgeted amount of \$79,157.

Further, the Authority's cost estimate was only for three of the fifty units and totaled \$9,068 (materials and labor) plus \$1,200 for an eight-month portable restroom rental. As a result, the executive director not only violated federal laws for procurement but also ignored the Authority's own procurement policies and procedures. The Authority also believed the regulations stated that if it was in the best interest of the Authority, it could move forward with a force account labor project. As a result, HUD cannot be assured that the cost of this project was reasonable.

Cost/price analysis table

Count	Grant number	Project name	Force account	Cost/price analysis performed
1	CA16P03950101	Air conditioning work projects 39-1 and 39-2	No	No
2	CA16P03950101	Roofing & air conditioning work project 39-9	No	No
3	CA16P03950101	Dwelling improvements - paint project 39-7	Yes	No*
4	CA16P03950101	Concrete mowstrips project 39-9	Yes	No
5	CA16P03950102	Site dwelling improvements - roofing project 39-2	No	No
6	CA16P03950102	Water heaters project 39-3	Yes	No
7	CA16P03950102	Concrete/exterior work project 39-3	Yes	Partial
8	CA16P03950103	Stove & refrigerators projects 39-1, 39-5 & 39-9	Yes	Yes**
9	CA16P03950103	Air conditioning replacement project 39-9	Yes	Yes**
10	CA16P03950104	Sewer lines project 39-2	Yes	Yes**
11	CA16P03950104	Shut-off valves project 39-7	Yes	Yes**
12	CA16P03950104	Restroom accessibility project 39-9	Yes	Yes**
13	CA16P03950104	Water heater doors project 39-1	Yes	Yes**
14	CA16P03950104	Kitchen cabinets project 39-3	Yes	Yes**
15	CA16P03950105	Site improvements project 39-2	No	Yes

* There are quotes for a one-gallon can of oil-based paint from three vendors but no estimates for how many cans of paint needed, additional materials, or labor.

** Analysis does not have a date.

Conclusion

The Authority violated federal procurement requirements and its own procurement policies for five procurement activities that required cost or price analysis and did not follow other procurement procedures. This condition occurred because the executive director ignored HUD rules and regulations and its procurement policies and procedures. As a result, the Authority spent at least \$827,756 without knowing whether the price was reasonable. It also spent at least \$184,588 on an activity for which it did not use the required sealed-bid method of procurement for construction contracts.

Recommendations

We recommend that HUD's Los Angeles Office of Public Housing require the Authority to

- 5A. Provide supporting documentation for \$827,756 or repay HUD from nonfederal funds for unsupported procurement activities.
- 5B. Repay HUD \$184,588 from nonfederal funds because the Authority did not use the required sealed-bid method for a construction contract over the simplified acquisition threshold.
- 5C. Follow HUD's and its own procurement requirements by preparing cost or price analyses before the Authority starts the procurement process for all future projects.
- 5D. Follow HUD's and its own procurement requirements by obtaining price or rate quotes from an adequate number of qualified sources or bid advertisements for all projects under the simplified acquisition threshold.
- 5E. Prepare justifications when force account labor is used for Authority projects and include more detailed documentation in its records showing that this method of providing the services is cost effective.
- 5F. Obtain written approval from HUD for all future force account projects.

SCOPE AND METHODOLOGY

We performed the audit between September 2007 and April 2008. The audit generally covered the period January 2001 through June 2007. To accomplish our objectives, we reviewed the effectiveness and efficiency of the Authority's operations, determined the reliability of its financial reporting, and reviewed its compliance with applicable laws and HUD regulations. Our primary methodologies included

- Reviewing the Quality Housing and Work Responsibility Act of 1998; applicable HUD regulations at 24 CFR [*Code of Federal Regulations*] Parts 85, 903, 906, 941, and 968; and HUD Guidebook 7485.3 G.
- Interviewing appropriate HUD personnel and relevant grant files to obtain an understanding of the public housing program requirements and identify HUD's concerns with the grantee's operations.
- Reviewing the Authority's policies, procedures, and practices in addition to interviewing the Authority's key personnel.
- Reviewing past OIG reports, independent public accountants' reports, and prior HUD monitoring reports.
- Reviewing bank statements, deposits, payment vouchers, and payroll.
- Reviewing tenant files, procurement files, general ledgers, and escrow documents.

Each of our tests conducted consisted of 100 percent of the universe since it was small. Specifically, we reviewed all of the funding used for the acquisition and operation of the Second Street Apartments. We also reviewed all the capital fund program grants received between 2001 and 2005. This review included all procurement contracts and force account labor activities. Lastly, we reviewed all of the tenant files for tenants currently participating in the Authority's public housing or Section 8 programs who once lived in the Second Street Apartments.

We conducted our audit in accordance with generally accepted government auditing standards and included tests of management controls that we considered necessary under the circumstances.

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:

- Authority policies and procedures put in place to ensure that the Authority follows Section 5(h) program requirements.
- Authority policies and procedures put in place to ensure that the Authority follows public housing program regulations.
- Authority policies and procedures put in place to ensure that the Authority complies with federal procurement requirements.
- Authority policies and procedures put in place to ensure that reliable data are entered into HUD's electronic Line of Credit Control System.

We assessed the relevant controls identified above.

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

Significant Weaknesses

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

- The Authority's controls were not adequate to ensure that it complied with its policies and procedures and Section 5(h) program policies for the use of program funds (see findings 1 and 2).
- The Authority's controls were not adequate to ensure that it complied with its policies and procedures and public housing program regulations as established by HUD (see findings 3 and 5).
- The Authority did not have policies and procedures in place to ensure that it entered reliable data into HUD's electronic Line of Credit Control System (see finding 3).
- The Authority's controls were not adequate to ensure that it complied with its policies and procedures and federal and state regulations for procurement (see findings 4 and 5).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible <u>1/</u>	Unsupported <u>2/</u>	Funds to be put to better use <u>3/</u>
1A	\$174,044		
2A			\$1,210,852
3A	\$247,101		
4A		\$12,830	
5A		\$827,756	
5B	\$184,588		
Total	\$605,733	\$840,586	\$1,210,852

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or federal, state, or local polices or regulations.
- 2/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.
- 3/ Recommendations that funds to be put to better use are estimates of amounts that could be used more efficiently if an OIG recommendation is implemented. The \$1.2 million comes from the money the Authority collected from 37 low-income families who purchased a single-family home within the Casas del Sol development. The implementation of our recommendation would put these funds to better use by either providing replacement housing or having HUD recapture the sales proceeds and reprogram the funds rather than allowing the funds to sit idle in a bank account.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

Ref to OIG Evaluation

Auditee Comments

Office of Inspector General
Revised Draft Audit Report
dated June 6, 2008

Auditee Comments

June 13, 2008

Mrs. Joan S. Hobbs, Regional Inspector General for Audit
Office of Inspector General Region IX
611 West Sixth Street, Suite 1160
Los Angeles, CA. 90017

Re: Housing Authority of the City of Calexico Audit draft Report

Dear Mrs. Hobbs:

Thank you for the opportunity to respond and provide comments to your department's draft finding report, related to the recently completed audit of our agency.

Finding 1

The Authority inappropriately used \$235,079 in Section 5(h) program funds, for the acquisition of Second Street Apartments.

Answer:

The Housing Authority of the City of Calexico's mission is to provide decent, safe, sanitary and affordable housing to low, very low and moderate income individuals and families in our community in great need of this type of assistance. It was with that mission in mind that our agency undertook a process to acquire a property in the City of Calexico that was known as "Second Street Property" that consisted of a 31 apartment complex, with the main goal of using this property as a replacement housing project under our HUD approved 5(h) homeownership plan.

During the acquisition process, several decisions were made, but it was never with the intent of this authority to act improperly or in conflict of the public interest. It was our desire to complete that task in good faith and with complete compliance to all applicable federal rules and HUD regulations, unfortunately our agency did not follow the required due process under this type of activity, therefore; resulting in this disallowance.

Comment 1

The Housing Authority of the City of Calexico (HACC) partially agrees with OIG comments related to the use of 5(h) funds, but we would like to clarify and emphasis on the following facts:

1. The \$235,079.00, reflected on the OIG report includes a payment made by our 5(h) sale proceeds to our public housing program back in April 16, 2005 on the amount of \$61,035.48. The payment was made to reimburse to the public housing program different expenses incurred for activities related to 5(h) homeownership plan that included the following: preparation of homeownership plan application, translation services, technical support related to the implementation of the plan, etc. All those expenses covered activity related to the 5(h) plan that was incurred during years 2001 and 2002 (see Exhibit A). Due to the previously mentioned, we believe the expense of \$61,035.48 was an eligible expenditure under the 5(h) plan and allowed under HUD regulations governing the homeownership plan.

Be it noted that the process to acquire the second street property started subsequent to the dates of the expenditures involving the \$61,035.48 and the amount was not related, in any way, to the acquisition or operation of second street property. We believe the amount in question should be adjusted to reflect \$174,043.52 (\$235,079.00-\$61,035.48).

Comment 2

2. Our adjusted amount of \$174,043.52, represents a combination of amounts utilized by this agency for the acquisition of the second street property, but also the amount of funds utilized by this agency to provide **affordable housing assistance payments** to the tenants living at the second street property for a period of approximate 24 months. As you verified during your review, the families living at second street property were low-income families paying a monthly flat rent of \$400.00, when the actual monthly rent that our agency paid to the owner of such property, was \$700.00. The difference between the actual rent and tenant rent (\$700.00- \$400.00=\$300.00), was absorbed by The Housing Authority of the City of Calexico under its 5(h) account, on monthly basis, with the main goal of helping those low income and very low income families to keep affordable housing.

Comment 3

Comment 4

Comment 8

3. In accordance to our knowledge, the \$174,043.52 absorbed by the 5(h) sale proceeds account, was an eligible activity permitted by the 5(h) regulation, related to the use of sale proceeds that under section 906.15 Use of Sale Proceeds, sub-section (a) General Authority for Use, that reflects the following: " Sales proceeds may after provision for sale and administrative costs that are necessary and reasonable for carrying out the homeownership plan, be retained by the PHA and used for housing assistance to low-income families (as such families are defined under the Act)". As previously mentioned, the loss absorbed by our 5(h) sale proceeds account, was utilized to provide housing assistance to low income families as permitted by the regulation governing the use of sale proceeds, therefore we believe that our agency incurred in no violation related to this matter.

Comment 4

Comment 5

Comment 6

Comment 7

Comment 8

Comment 5
Comment 6
Comment 9

FINDING 2

The Authority Did Not Provide Replacement Units For Units Sold.

ANSWER:

As we informed OIG staff during exit conference, the HACC position is that the 5(h) homeownership plan **DOES NOT REQUIRE** a replacement project.

In fact, in a letter from U.S. Department of Housing and Urban Development, Special Application Center in Chicago Illinois, dated 9/29/1999 (*see Exhibit B*), **our agency was required to delete** the requirement related to a Replacement Project.

Furthermore the letter reflects that proceeds from the sale can be used for the replacement units at the PHA's discretion.

Based on the aforementioned, we strongly believe that no violation exist related to this issue, nevertheless we are already following OIG recommendations. Our agency has advertised and obtained proposals (*see Exhibit C*) from firms to develop a replacement housing project.

Once proposals are reviewed and a decision made by the Board of Commissioners in regards to how our agency will proceed and prior to starting any activity related to the replacement project, the HACC will approach HUD local office to obtain any required approval from that office related to this matter this should prevent any potential problem related to violations of procedure involving this type of activity.

FINDING # 3

The Authority Incorrectly Reported Its Grants In The Electronic Line Of Credit Control System As Fully Obligated.

Answer:

2001.

The HACC agrees with OIG comments related to this particular grant, however we would like to express the following: The United States Housing Act of 1937 as amended by the Quality Housing and Work Responsibility Act of 1998 As of 3/2/1999 (*see exhibit C*), Section (j) Penalty for Slow Expenditure of Capital Funds, Sub-section (1), Obligation of Amounts, Paragraph (B), that reads as follow: "**shall disregard the requirement of paragraph (1) with respect to any un-obligated amount made available to a public housing agency, to the extent that the total of such amounts do not exceed 10 percent of the original amount made available to a the public housing agency**". The un-obligated amount under this grant involves \$69,310.00 which is less than 10% of the total grant amount of \$739,301.00 and therefore the un-obligated amount does not exceed the threshold established by the

Comment 10

Comment 10
Comment 11

QHWRA act governing this activity. We believe that our agency should not be subject to any recapture or repayment of these funds.

Our agency intends on following recommendations from OIG and is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

2003

As reflected in your report, our agency spent less funds than the ones budgeted for different activities under this grant, resulting in left over funds (savings) that were utilized by this agency using force account labor. We want to mention that according to HUD regulations and more specifically in accordance to HUD handbook 7485.3 G, Part B, Part III Implementation Schedule, sub-section 2 No Prior HUD approval, that reads as follow: **“The HA may extend the target dates for fund obligation or expenditure in the approved annual statement without prior HUD approval whenever any delay outside of the HA’s control occurs....”** **“example of the delay outside of the HA’s control include: a. Need to use onobligated funds which are left over after completion of all planned work under the annual statement for additional work included in the five-year action plan”.**

Based on the aforementioned, and as reflected on page 14, Paragraph four of your report, our agency started on September 2006 using left over funds (savings) to perform some work reflected in the five year plan as allowed by 24 CFR, Part 968, Subpart C. Please note that left over funds/saving represent un-obligated funds that are permitted to be spent after obligation dates due to delays out of the PHA’s control, therefore; we believe that the \$134,660 spent by our agency under this grant were spent in accordance to HUD regulations governing this grant.

As recommended by OIG, our agency is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grant(s) to ensure proper compliance and prevent future potential problems related to this issue.

As recommended by OIG our agency will provide copies of executed contracts to HUD Los Angeles office regardless of the amount in support of all future funds that the authority obligates.

Answer:

2005

As reflected on your report, our agency executed a contract in the amount of \$329,960 in September 2007 and reported 100% of funds obligated in August 2007. The reason for reflecting an obligation at 100% in August 2007 (which was the obligation deadline), was because the contract was awarded during an official Board of Commissioners meeting held on August 16, 2007 (*see Exhibit D*). Based on the contract award the full amount of funds under the 2005 grant were obligated. To avoid future problems the agency intends to follow OIG recommendations and is

Comment 12

Comment 13

currently in the process of adopting written policies and procedures related to obligations and expenditure of funds under the capital fund grants program to ensure proper compliance.

FINDING # 4

The Authority Undertook a Force Account Activity without HUD's Written Approval.

Answer:

The HACC agrees with OIG comments related to the use of force account without proper written approval from HUD office. Nevertheless, we would like to mention that the use of force account under this activity was based on the Independent Cost Estimate (ICE) prepared by this agency, which resulted in substantial savings to this agency.

As recommended by OIG we are providing an ICE (*see Exhibit E*), reflecting the estimated amounts needed to perform this work using wage rates and materials costs effective at the time that the work was performed. As you will notice the ICE prepared by this agency reflects that the estimated amount needed to perform this activity was approximate \$32,117.28 and we were able to perform the work with only \$12,830.00. This work was very cost effective work and resulted in substantial savings for our agency.

As recommended by OIG our agency will obtain prior written approval from HUD office prior to the implementation of all future force account projects.

In addition, our agency is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

FINDING # 5

The Authority Did Not Follow Federal Requirements for Procurements and Spent \$1,012,344 on Unsupported and Ineligible Costs.

Answer:

The HACC agrees with OIG comments related to the lack of cost or price analysis in some of projects undertaken by our agency in the past, nevertheless; we want to emphasize the fact that our agency has corrected this deficiency and has prepared and included an independent cost estimated (ICE) in every project that has taken place within the last five years, and this issue was confirmed by the OIG staff and reflected on page 18 of your report where you listed the different projects that contained the required cost price analysis.

Comment 14

In addition and as recommended by OIG office, our agency is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

In regards to your recommendations reflected on page 19 of your report, we are providing you the following information/documentation to support each item.

1. Copy of executed contract between our agency and Slayton Mechanical Contractor, Inc. in the amount of \$170,000.00 and ICE, which shows that costs were reasonable (*see Exhibit F*).
2. Copy of executed contract between our agency and Locke Air Conditioning Company in the amount of \$360,991.00 and ICE, which shows that costs were reasonable (*see Exhibit G*).
3. Copy of executed contract between our agency and Universal Coatings Inc., in the amount of \$217,000.00, copy of ICE, which shows that costs were reasonable (*see Exhibit H*).
4. Copy of cost estimate prepared by our agency to support the amount of \$47,290.00 that was spent for painting activity and showing that the amount spent was reasonable and furthermore resulted in a great saving for our agency and ICE, which shows that costs were reasonable (*see Exhibit I*).
5. Copy of invoice from Ferguson Enterprises, Inc. on the amount of \$32,475.00, for the purchase of water heaters installed at public housing properties (*see Exhibit J*).

Comment 15

We have included a cost estimate summary for the aforementioned questioned cost which adds up to \$827,756 (*see Exhibit K*),

Answer to item 5B.

We agree with OIG comments related to our oversight of sealed bids requirements, but want to mention that all \$184,588 utilized under the force account undertaken by this agency to perform concrete work was cost effective and resulted in physical improvements highly needed in our developments to correct deficiencies related to safety and access issues per 504 Compliance Review, REAC inspections and to improve the living environment of our public housing residents.

An independent cost estimated prepared by this agency (*see Exhibit L*), shows that the estimated amount needed to perform the same work utilizing a private company/general contractor would result in approximate \$224,550.00, this amount is almost 80% more of what we ended up paying for the work performed.

Comment 16

We would like to emphasize that our agency utilized these funds to perform physical improvements in different developments that were deferred during previous fiscal years. We understand the importance of properly documenting every single activity performed under this grant(s), that is why our agency is following OIG recommendations and is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

Answer to item 5C.

As reflected in the previous response to your findings, our agency is following OIG recommendations and is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

Answer to item 5D.

As reflected in the previous response to your findings, our agency is following OIG recommendations and is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

Answer to item 5E.

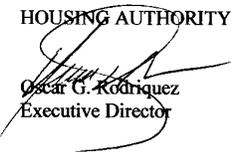
As reflected in the previous response to your findings, our agency is following OIG recommendations and is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

Answer to item 5F.

As reflected in the previous response to your findings, our agency is following OIG recommendations and is currently in the process of adopting written policies and procedures related to obligation and expenditures of funds under the capital fund grants to ensure proper compliance.

Sincerely,

HOUSING AUTHORITY OF THE CITY OF CALEXICO


Oscar G. Rodriguez
Executive Director

OIG Evaluation of Auditee Comments

Comment 1 We agree that these costs were eligible 5(h) program expenses since these costs were for consulting fees related to the Authority's Section 5(h) implementing agreement. We also agree that the \$61,035.48 was paid out in 2001, thus it was not related to the acquisition of the Second Street Apartments. Therefore, we removed these questioned costs from the audit report.

Comment 2 We disagree. The Authority's 5(h) Implementing Agreement and Homeownership Plan was approved in May 2001. The 24 [*Code of Federal Regulations*] 906.16 in effect at the time of the Authority's approval, with a revision date of April 1, 2001 states, "(a) Replacement requirement. As a condition for transfer of ownership under a HUD-approved homeownership plan, the PHA must obtain a funding commitment, from HUD or another source, for the replacement of each of the dwellings to be sold under the plan. Replacement housing may be provided by one or any combination of the following methods:

(1) Development by the PHA of additional public housing under 24 CFR part 941 (by new construction or acquisition).

(2) rehabilitation of vacant public housing owned by the PHA.

(3) Use of five-year, tenant-based certificate or voucher assistance under Section 8 of the Act.

(4) If the homeownership plan is submitted by the PHA for sale to residents through an RMC, resident organization or cooperative association which is otherwise eligible to participate under this part, acquisition of nonpublicly-owned housing units, which the RMC, resident organization or cooperative association will operate as rental housing, comparable to public housing as to term of assistance, housing standards, eligibility, and contribution to rent.

(5) Any other Federal, State, or local housing program that is comparable, as to housing standards, eligibility and contribution to rent, to the programs referred to in paragraphs (a) (1) through (a) (3) of this section, and provides a term of assistance of not less than five years."

By the Authority's own admission, assistance was provided "for a period of approximately 24 months". Based on the information in bold up above, the \$300/unit that was subsidized by the Authority does not qualify.

Comment 3 We disagree. In addition to the criteria in Comment 2 above, the Implementation Agreement states under definitions, "low-income families – This term has the meaning ascribed to it in section 3 of the Act". Also, the Implementation Agreement states in Section 3.1, "The HA [housing authority] agrees that sale proceeds shall be used only in accordance with the Plan, and the requirements and provisions of this Agreement, and certifies that the Plan complies with 24 CFR [*Code of Federal Regulation*] 906.15, governing the use of sales proceeds". The 24 [*Code of Federal Regulation*] 906.15 states, "(a) General authority for use.

Sale proceeds may, after provision for sale and administrative costs that are necessary and reasonable for carrying out the homeownership plan, be retained by the PHA and used for housing assistance to low-income families (as such families are defined under the Act”. The Quality Housing and Work Responsibility Act states in Section 3 (5)(C)(b)(2) “When used in this Act: The term “low-income families” means those families whose income does not exceed 80 per centum of the median income for the area, as determined by the Secretary with adjustments for smaller and larger families, except that that Secretary may establish income ceilings higher or lower than 80 per centum of the median for the area on the basis of the Secretary’s findings that such variations are necessary because of prevailing levels of construction costs or unusually high or low family incomes...”

Also, Section 3 (a)(1) of the Quality Housing and Work Responsibility Act states, “Dwelling units assisted under this act shall be rented only to families who are low-income at the time of their initial occupancy of such units. Reviews of family income shall be made at least annually. Except as provided in paragraph (2) and subject to the requirement under paragraph (3), a family shall pay as rent for a dwelling unit assisted under this Act (other than a family under section 8(o) or (y) or paying rent under section 8(c)(3)(B) the highest of the following amounts, rounded to the nearest dollar...”

Comment 4 In addition to comment 3 above, the Authority did not provide us with files on all of the tenants whose rents were subsidized \$300 per month and we had no evidence that reviews of family income was done at least annually. Additionally, the Second Street Apartments were not units assisted under this Act. Finally, many of the families who moved into the Second Street Apartments ultimately had to move because of their inability to afford the \$400 flat rate that they were charged.

Comment 5 We disagree. The 24 [*Code of Federal Regulations*] 906.15 in effect at the time of the Authority’s 5(h) Plan approval, with a revision date of April 1, 2001 states, “(a) General authority for use. Sale proceeds may, after provision for sale and administrative costs that are necessary and reasonable for carrying out the homeownership plan, be retained by the PHA and used for housing assistance to low-income families (as such families are defined under the Act)...” (b) Permissible uses. Sale proceeds may be used for any one or more of the following forms of housing assistance for low-income families, at the discretion of the PHA and as stated in the HUD-approved homeownership plan: (3) In connection with a State or local homeownership program for low-income families, as described in the homeownership plan, for assistance to purchasers and for reasonable planning and implementation costs. Under such programs, sales proceeds may be used to construct or acquire additional dwellings for sale to low-income families, or to assist such families in purchasing other dwellings from public or private owners. (4) In connection with the PHA’s [Public Housing Authority] other public housing that remains under ACC, for any purposes

authorized for the use of operating funds under the ACC and applicable provisions of the Act and Federal regulations, as included in the HUD-approved operating budgets. Examples include maintenance and modernization, augmentation of operating reserves, protective services, and resident services. Such use shall not result in the reduction of the operating subsidy otherwise payable to the PHA under 24 CFR part 990". (5) In connection with any other type of Federal, State, or local housing program for low-income families, as described in the homeownership plan.

The \$174,043.52 that was absorbed by the 5(h) sales proceeds account, was not an eligible activity based on both the 24 [*Code of Federal Regulation*] 906.15 and the HUD-approved homeownership plan.

Comment 6 We disagree. The Authority stated in section 5.0 of its approved 5(h) Plan "... The Authority will use these funds for two primary purposes, including (1) new development replacement housing; and (2) Casas del Sol homebuyers' assistance..." Section 5.1 states, "After using proceeds of sale to cover homebuyer assistance needs and any necessary repairs to bring all units to required standards, the Authority will use the balance of funds to facilitate the development of replacement units, combining these funds with proceeds from the sale of tax credits derived from the new development..."

The portion of the \$174,043.52 that was absorbed by the 5(h) sales proceeds for supplementing rents for tenants was not covered by the 5(h) Plan.

Comment 7 The Second Street Apartments does not qualify under the Quality Housing and Work Responsibility Act, which states the following in Section 3, (5)(C)(b)(1) "When used in this Act: The term "low-income housing" means decent, safe, and sanitary housing, and all necessary appurtenances thereto, assisted under this Act other than under Section 8. The term "public housing" includes dwelling units in a mixed finance project that are assisted by a public housing agency with capital or operating assistance". Therefore, it was not an eligible activity.

Comment 8 We disagree. Section 3 (2)(B)(i) of the Quality Housing and Work Responsibility Act states the following in regards to Flat Rents, "Allowable Rent Structures. – Flat Rents. – Except as otherwise provided under this clause, each public housing agency shall establish, for each dwelling unit in public housing owned or operated by the agency, a flat rental amount for the dwelling unit, which shall (I) be based on the rental value of the unit, as determined by the public housing agency; and (II) be designed in accordance with subparagraph (D) so that the rent structures do not create a disincentive for continued residency in public housing by families who are attempting to become economically self-sufficient through employment or who have attained a level of self-sufficiency through their own efforts.

The rental amount for a dwelling unit shall be considered to comply with the requirements of this clause if such amount does not exceed the actual monthly

costs to the public housing agency attributable to providing and operating the dwelling unit. The preceding sentence may not be construed to require establishment of rental amounts equal to or based on operating costs or to prevent public housing agencies from developing flat rents required under this clause in any other matter that may comply with this clause”.

In this case, the rent structure did create a disincentive for continued residency at the Second Street Apartments because the OIG determined many of the tenants moved out due to their inability to afford the flat rate charged.

Comment 9 We disagree. While the Authority may have been told by the Special Applications Center in Chicago “proceeds from the sale can be used for replacement units at the PHA’s discretion”, the 5(h) Implementing Agreement signed by the Authority states in Section 3.3, “ The HA shall obligate sales proceeds in a timely fashion, in accordance with the project implementation schedule set forth in the Plan”. Therefore, the Authority should have provided the required replacement units. Also see Comments 5 and 6.

Comment 10 We disagree with the Authority and contend that the funds should be recaptured. Notice: PIH [Public and Indian Housing] 2003-19 (PHA) [Public Housing Authority] (9)(A) states, “The HUD FY 2003 Appropriations Act was signed on February 20, 2003. The Appropriations Act provides new requirements with regard to funds not obligated by the deadline. Specifically, the Appropriations Act provides that:

Notice: PIH [Public and Indian Housing] 2003-19 (PHA) [Public Housing Authority] (9)(A) also states, “any amounts made available under the public housing Capital Fund for fiscal years 1999, 2000, 2001, 2002, or 2003 that remain unobligated in violation of paragraphs (1) of such section 9(j) or unexpended in violation of paragraph (5)(A) of such section 9(j), the Secretary *shall* recapture any such amounts...” This Notice specifically says any amounts that remain unobligated will be recaptured.

In addition, the auditee was still in the process of establishing and implementing its new procedures; thus, we were unable to review them and determine their adequacy during our audit fieldwork.

Comment 11 In this case, the Authority did not inform the Field Office (FO) and therefore, a revised obligation end date was not entered into the Line of Credit Control System. Additionally, no post-review by the field office was conducted in order to determine if Authority had the continuing capacity to carry out its Comprehensive Plan in a timely manner. Furthermore, HUD had the right to take other appropriate actions.

The HUD handbook 7485.3G Chapter 6-10 Part III Implementation Schedule states, “No Prior HUD Approval. The HA may extend the target dates for fund

obligation or expenditure in the approved Annual Statement without prior HUD approval whenever any delay outside of the HA's control occurs. Where the HA revises its implementation schedule, the HA shall inform the FO so that the FO may enter a revised Obligation End Date in LOCCS. Such revision is subject to post-review by the FO in determining whether the HA has a continuing capacity to carry out its Comprehensive Plan in a timely manner (see paragraph 12-8). In addition, HUD may take other appropriate action as set forth in paragraph 12-9. Examples of delay outside of the HA's control include:

- a. Need to use unobligated funds which are left over after completion of all planned work under an Annual Statement for additional work included in the Five-Year Action Plan;
- b. Unforeseen delays in contracting or contract administration, such as the need to rebid due to no bids received or bids received over budget, hidden conditions, etc;
- c. Litigation, where approved by HUD; and
- d. HUD or other institutional delay, excluding delay by the HA itself (i.e., HA staff, Executive Director or Board of Commissioners)".

Also, see Comment 10.

Comment 12 As discussed at the exit conference, we view the date the contract was executed as the obligation date, not the date the Board of Commissioners agreed to the contract. Additionally, while the Board of Commissioners may have met and discussed this contract on August 16, 2007 the minutes state, the attorney "announced that at the time of the bid submission the lowest bidder failed to submit certificates required. He has reviewed the information and he is satisfied to award the contract to the lowest bidder, 3D Construction with the condition that he submits the required documents by no later than 1:00 PM, if not able to comply to proceed and award contract to the second lowest bidder which is Trademark Construction after the deductive." Clearly, by the close of this Board meeting, the Authority had neither a contractor nor a signed contract.

Comment 13 We acknowledge that the Authority submitted a cost estimate based on the HomeTech Remodeling and Renovation Cost Estimator/California/2005. However, this estimate was not prepared until after the fact, in June 2008. Additionally, according to 24 [Code of Federal Regulations] 85.36(f)(1), independent estimates are supposed to be made *before* the bids or proposals are received. Therefore, if the Authority cannot show it performed these estimates before the bids were received, the costs would become questioned. Any estimate performed in 2008, or after-the-fact is not acceptable.

- Comment 14** The OIG reviewed the contracts submitted in exhibits “F” through “J” during the audit, therefore, the OIG’s comments were about the lack of price or cost estimates. We acknowledge that the Authority submitted cost estimates based on the HomeTech Remodeling and Renovation Cost Estimator/California/2005. However, these estimates were not prepared until after the fact, in June 2008. Also, see Comment 13.
- Comment 15** We agree that based on the Authority’s prepared cost estimates that were done after the fact, in June 2008, the actual expenses appear to be less than the cost estimates. However, 2005 costs were used to estimate the cost of work contracted in 2002, 2003, and 2004. In addition, as stated in Comment 13, independent estimates are supposed to be made *before* the bids or proposals are received. Therefore, if the Authority cannot show it performed these estimates before the bids were received, the costs would become questioned. Any estimate performed in 2008, or after-the-fact is not acceptable. Also, see Comment 10.
- Comment 16** After reviewing the newly prepared cost estimates, we disagree that the estimated amount is more than 80 percent of the \$184,588 that the Authority spent. Actually, this cost estimate of \$224,550 is only about 18 percent ($(\$224,550 - \$184,588)/\$224,550$) more than what the Authority actually spent. In addition, the auditee was still in the process of establishing and implementing its new procedures; thus, we were unable to review them and determine their adequacy during our audit fieldwork. Also, see Comment 10.

Appendix C

CRITERIA

1. **Quality Housing and Work Responsibility Act of 1998, Section 32(a) (42 United States Code 1437g(j)(1))**, states, “a public housing agency may carry out a homeownership program in accordance with this section and the public housing agency plan of the agency to make public housing projects available for purchase by low-income families for use only as principal residences for such families. An agency may transfer a unit pursuant to a homeownership program only if the program is authorized under this section and approved by the Secretary.”
2. **Quality Housing and Work Responsibility Act of 1998, Section 32(b) (42 United States Code 1437g(j)(1))**, states, “a program under this section may cover any existing public housing dwelling units or projects, and may include other dwelling units and housing owned, assisted, or operated by the public housing agency.”
3. **Quality Housing and Work Responsibility Act of 1998, Section 32(c) (42 United States Code 1437g(j)(1))**, states, “only low-income families assisted by a public housing agency, other low-income families, and entities formed to facilitate such sales by purchasing housing under a homeownership program under this section.”
4. **24 CFR [Code of Federal Regulations] 968.105** states, “Force account labor. Labor employed directly by the PHA [public housing authority] on either a permanent or a temporary basis.”
5. **Section 5(h) Implementing Agreement, section (3.1)**, states, “the HA [housing authority] agrees that sale proceeds shall be used only in accordance with the Plan, and the requirements and provisions of this Agreement, and certifies that the Plan complies with 24 CFR 906.15, governing the use of sale proceeds.”
6. **Quality Housing and Work Responsibility Act of 1998, Section 32(j) (42 United States Code 1437z-4(a))**, states, “the net proceeds of any sales under a homeownership program under this section remaining after payment of all costs of the sale shall be used for purposes relating to low-income housing and in accordance with the public housing agency plan of the agency carrying out the program.”
7. **Section 5(h) Implementing Agreement, section (3.5)**, states, “the HA’s Board of Commissioners shall be responsible for implementing the Plan and ensuring that sale proceeds are used in accordance with the requirements of this Agreement. The Board of Commissioners also shall be responsible for all phases of any program developed under the Plan.”
8. **24 CFR [Code of Federal Regulations] 906.16(a)** states, “Replacement requirement. As a condition for transfer of ownership under a HUD-approved homeownership plan, the PHA must obtain a funding commitment, from HUD or another source, for the

replacement of each of the dwellings to be sold under the plan. Replacement housing may be provided by one or any combination of the following methods...

9. **Annual Contributions Contract, section (9)(C)**, states, “the HA shall maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program regulation and requirement. The HA may withdraw funds from the General Fund only for: (1) the payment of the costs of development and operation of the projects under the ACC [annual contributions contract] with HUD; (2) the purchase of investment securities as approved by HUD; and (3) such other purposes as maybe specifically approved by HUD. Program funds are not fungible; withdrawals shall not be made for a specific program in excess of the funds available on deposit for that program.”
10. **Annual Contributions Contract, section (10)(C)**, states, “the HA shall not withdraw from any of the funds or accounts authorized under this section amounts for the projects under ACC, or for the other projects or enterprises, in excess of the amount then on deposit in respect thereto.”
11. **24 CFR [Code of Federal Regulations] 906.19** states, “Upon HUD notification to the PHA that the homeownership plan is approvable (in final form that satisfies all applicable requirements of this part), the PHA and HUD will execute a written implementing agreement, in a form prescribed by HUD, to evidence HUD approval and authorization for implementation. The plan itself, as approved by HUD, shall be incorporated in the implementing agreement. Any of the items of supporting documentation may also be incorporated, if agreeable to the PHA and HUD. The PHA shall be obligated to carry out the approved homeownership plan and other provisions of the implementing agreement without modification, except with written approval by HUD.”
12. **24 CFR [Code of Federal Regulations] 906.20** states, “The homeownership plan must address the following matters, as applicable to the particular factual situation:
(n) An estimated timetable for the major steps required to carry out the plan.”
13. **Quality Housing and Work Responsibility Act of 1998 (42 United States Code 1437g(j)(1))** states, “Except as provided in paragraph (4) and subject to paragraph (2), a public housing agency shall obligate any assistance received under this section not later than 24 months after, as applicable—
 - (A) The date on which the funds become available to the agency for obligation in the case of modernization; or
 - (B) The date on which the agency accumulates adequate funds to undertake modernization, substantial rehabilitation, or new construction of units.”
14. **Quality Housing and Work Responsibility Act of 1998 (42 United States Code 1437g(j)(6))** states, “Right of Recapture. Any obligation entered into by a public housing

agency shall be subject to the right of the Secretary to recapture the obligated amounts for violation by the public housing agency of the requirements of this subsection.”

15. **24 CFR [Code of Federal Regulations] 905.120(b)(3)** states, “Disregard of minimal unobligated amounts. HUD will disregard the requirements of paragraph (a) of this section with respect to any unobligated amounts made available to a PHA, to the extent that the total of such amounts does not exceed 10 percent of the original amount made available to the PHA.”
16. **Notice: PIH [Public and Indian Housing] 2003-19 (PHA) [Public Housing Authority] (9)(A)** states, “any amounts made available under the public housing Capital Fund for fiscal years 1999, 2000, 2001, 2002, or 2003 that remain unobligated in violation of paragraphs (1) of such section 9(j) or unexpended in violation of paragraph (5)(A) of such section 9(j), the Secretary *shall* recapture any such amounts...”
17. **Notice: PIH [Public and Indian Housing] 2005-22(11)** states, “the Act and the regulation provide sanctions for PHAs that do not obligate in a timely manner. Specifically, HUD is to withhold a PHA’s next Capital Fund grant(s) until the PHA obligates 90 percent of its past due grant. If the PHA cures its failure to comply with the obligation requirement during the year, HUD will release the new Capital Fund grant(s). The penalty for noncompliance will be to reduce the new Capital Fund grant(s) by 1/12 for every month the PHA was in noncompliance.”
18. **24 CFR [Code of Federal Regulations] 968.305** states, “fungibility is a concept which permits a PHA to substitute any work item from the latest approved Five-Year Action Plan to any previously approved CIAP [comprehensive improvement assistance program] budget or CGP [comprehensive grant program] Annual Statement and to move work items among approved budgets without prior HUD approval.”
19. **24 CFR [Code of Federal Regulations] 968.120(a)** states, “for both CIAP and CGP, a PHA may undertake the activities using force account labor, only where specifically approved by HUD in the CIAP budget or CGP Annual Statement, except no prior HUD approval is required where the PHA is designated as both an overall high performer and Modernization high performer under the PHMAP [public housing management assessment program].”
20. **24 CFR [Code of Federal Regulations] 902.67(a)(1)** states, “a PHA that achieves a score of at least 60 percent of the points available under each of the four PHAS [public housing assessment system] Indicators (addressed in subparts B through E of this part) and achieves an overall PHAS score of 90 percent or greater of the total available points under PHAS shall be designated a high performer.”
21. **24 CFR [Code of Federal Regulations] 902.67(a)(2)** states, “a PHA shall not be designated a high performer if it scores below the threshold established for any indicator.”

22. **24 CFR [Code of Federal Regulations] 85.36(b)(1)** states, “grantees and subgrantees will use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and the standards identified in this section.”
23. **24 CFR [Code of Federal Regulations] 85.36(b)(9)** states, “grantees and subgrantees 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. **24 CFR [Code of Federal Regulations] 85.36(c)(1)** states, “all procurement transactions will be conducted in a manner providing full and open competition consistent with the standards of Sec. 85.36.”
25. **24 CFR [Code of Federal Regulations] 85.36(d)(1)** states, “procurement by small purchase procedures. 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. 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.”
26. **24 CFR [Code of Federal Regulations] 85.36(f)(1)**, states, “grantees and subgrantees must perform a cost or price analysis in connection with every procurement action including contract modifications. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, grantees must make independent estimates before receiving bids or proposals. A cost analysis must be performed when the offeror is required to submit the elements of his estimated cost, e.g., under professional, consulting, and architectural engineering services contracts. A cost analysis will be necessary when adequate price competition is lacking, and for sole source procurements, including contract modifications or change orders, unless price reasonableness can be established on the basis of a catalog or market price of a commercial product sold in substantial quantities to the general public or based on prices set by law or regulation. A price analysis will be used in all other instances to determine the reasonableness of the proposed contract price.”