



The Municipality of Arecibo, PR
Community Development Block Grant Program



Issue Date: March 22, 2013

Audit Report Number: 2013-AT-1003

TO: Maria Ortiz, Director, Community Planning and Development, San Juan Field Office, 4ND

//signed//

FROM: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

SUBJECT: The Municipality of Arecibo, PR, Did Not Always Ensure Compliance With Community Development Block Grant Program Requirements

Enclosed is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General (OIG), final results of our review of the Municipality of Arecibo's Community Development Block Grant 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 8L, 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.



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The Municipality of Arecibo, PR, Did Not Always Ensure Compliance With Community Development Block Grant Program Requirements

Highlights

Audit Report 2013-AT-1003

What We Audited and Why

As part of the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) annual plan and based on the large amount of funds approved, we audited the Municipality of Arecibo's Community Development Block Grant program. Our main objective was to determine whether the Municipality complied with HUD regulations, procedures, and instructions related to the administration of its Block Grant program.

What We Recommend

We recommend that HUD (1) determine the eligibility of more than \$4.6 million disbursed for unsupported Block Grant program costs, (2) require the repayment of more than \$500,000 in ineligible expenditures, (3) require the Municipality to develop a financial management system in accordance with HUD requirements and provide related training to its staff, (4) require the Municipality to charge only eligible program delivery costs to the Block Grant program, and (5) require the Municipality to improve its housing rehabilitation program to ensure that Block Grant funds are used in accordance with HUD regulations.

What We Found

The Municipality's financial management system did not properly identify the source and application of more than \$1.8 million in Block Grant funds and did not support the eligibility of more than \$400,000. As a result, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for requested and eligible purposes.

The Municipality charged the Block Grant program more than \$1.6 million as activity costs associated with wages without supporting the basis and reasonableness of funds charged. Therefore, HUD had no assurance that funds were used solely for eligible purposes and that Block Grant-funded activities met program objectives.

The Municipality did not support more than \$1.2 million spent in its housing rehabilitation and road reconstruction activities and did not demonstrate compliance with the Block Grant national objective. Consequently, HUD lacked assurance that Federal funds drawn for housing rehabilitation and street improvement efforts met program objectives and that Block Grant funds were used solely for authorized purposes.

The Municipality generally complied with requirements for planning, soliciting, and awarding contracts and purchase orders. However, it failed to perform a required cost analysis in one contract and did not always maintain adequate documentation of all of its procurement history. As a result, it did not support the reasonableness of more than \$124,000 disbursed in an awarded construction contract.

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BACKGROUND AND OBJECTIVE

The Community Development Block Grant program is funded by the U.S. Department of Housing and Urban Development (HUD). It provides annual grants on a formula basis to entitled cities, urban counties, and States to develop viable urban communities by providing decent housing and a suitable living environment and by expanding economic opportunities, principally for low- and moderate-income persons.

The Municipality of Arecibo is an entitlement recipient administering more than \$13.69 million in Community Development Block Grant funds approved by HUD during the last 5 years ending June 30, 2012. HUD's Integrated Disbursement and Information System¹ reflected Block Grant expenditures exceeding \$4.8 million during fiscal years ending June 30, 2011, and 2012, for the following activities:

Block Grant activity	Fiscal year 2011	Fiscal year 2012
Public facilities and improvements	\$786,679	\$1,012,907
Housing rehabilitation	749,720	545,081
Planning and administration	522,454	454,582
Public services	<u>406,353</u>	<u>337,167</u>
Total	<u>\$2,465,206</u>	<u>\$2,349,737</u>

The Municipality's Development Department is responsible for administering the Block Grant program. Its books and records are maintained at José de Diego Street, Arecibo, PR. We audited the Municipality's Block Grant program as part of the HUD Office of Inspector General's (OIG) strategic plan. The Municipality was selected for review based on the amount of HUD funding provided.

The objective of the audit was to determine whether the Municipality complied with HUD regulations, procedures, and instructions related to the administration of the Block Grant program. Specifically, we evaluated whether (1) its financial management system complied with HUD requirements, (2) it disbursed Block Grant funds for allowable and supported costs, (3) funded activities met national objectives, and (4) it followed HUD's and its own procurement requirements.

¹ HUD's Integrated Disbursement and Information System is the drawdown and reporting system for the four community planning and development formula grant programs. The system allows grantees to request their grant funding from HUD and report on what is accomplished with these funds.

RESULTS OF AUDIT

Finding 1: The Municipality's Financial Management System Did Not Comply With HUD Requirements

The Municipality's financial management system did not properly identify the source and application of more than \$1.8 million in Block Grant funds and did not support the eligibility of more than \$422,000 in program charges. These deficiencies occurred because of a lack of training of the accounting staff and poor oversight of financial management processes. As a result, HUD lacked assurance that all funds were adequately accounted for, safeguarded, and used for requested and eligible purposes and in accordance with the Block Grant program requirements.

Inadequate Accounting Records

The Municipality's accounting records did not reflect complete and accurate financial information on Block Grant program activities and did not permit the adequate tracing of program receipts and expenditures. Regulations at 24 CFR (Code of Federal Regulations) 85.20(b) require grantees to maintain financial records that are accurate, current, and complete and that adequately identify the source and application of funds provided for assisted activities. However, the Municipality's accounting records did not comply with HUD requirements and were not adequate for the preparation of reports. For example, the Municipality did not maintain a general ledger for the Block Grant program. The records maintained did not reflect disbursement by grant, activity, and funding type and did not properly account for capital assets. We also found several instances in which the Municipality charged expenditures to the incorrect activity.

In addition, the Municipality's accounting records did not reflect the disposition of more than \$1.8 million for the Block Grant program. An analysis of amounts posted in the Municipality's check register and amounts drawn from HUD's system reflected that the Municipality drew down more Federal funds than the amount disbursed for payroll expenses during the period July 1, 2009, through December 31, 2011. As of December 2011, HUD's system reflected that the Municipality had withdrawn more than \$5.3 million in Federal funds, but Municipality records showed just over \$3.5 million in disbursements. The difference of more than \$1.8 million, according to the Municipality, represented electronic transfers made between bank accounts to cover payroll expenses; however, these costs were not reflected in the Block Grant program accounting records. A Municipality official stated that the information was kept by the Municipality's Finance Office; however, it was not readily available for our review.

The Municipality did not maintain a financial management system that permitted the tracing of funds to a level which ensured that such funds had not been used in violation of the restrictions and prohibitions of applicable statutes. As a result, HUD lacked assurance that funds were adequately accounted for, safeguarded, and used for eligible purposes. A Municipality official informed us that the Municipality was implementing a new financial management system that would address the shortcomings of the system.

Unsupported Program Disbursements

The Municipality charged the Block Grant program the full lease cost of its office space, although part of the space was occupied by a division that performed general government activities not associated with the Block Grant program. The Municipality did not prorate the lease cost; therefore, \$385,164 in rent charges between July 1, 2009, and June 30, 2012, was considered unsupported pending a HUD eligibility determination of the proper cost allocation. In addition, the Municipality did not provide documentation supporting the reasonableness, allowability, and allocability of \$37,228 charged to the Block Grant program, associated with administrative and other activity-related expenses. Specifically, it did not provide disbursement vouchers or other support evidencing costs charged to the program. The administrative costs were charged mainly to professional consulting service-related expenses.

Lack of Training and Inadequate Oversight of Financial Management

The Municipality had not provided sufficient financial management-related training to its accounting staff to ensure that Block Grant funds were adequately accounted for. According to accounting staff members, they had not received training for about 20 years. Municipality management also had not provided clear guidance on how to maintain an accounting system that provides timely and accurate accounting information on Block Grant program-related transactions. Therefore, due to the lack of training, proper guidance, and oversight, the Municipality's accounting staff was not aware of all Federal requirements concerning financial management systems.

Conclusion

The Municipality maintained a financial management system that (1) did not reflect the full history of all financial transactions, (2) did not properly identify the source and application of Block Grant funds, and (3) permitted program charges for unsupported costs. This condition occurred due to a lack of training of

accounting staff and poor oversight of financial management processes. As a result, HUD lacked assurance that funds were used only for requested and eligible purposes.

Recommendations

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

- 1A. Develop a financial management system in accordance with HUD requirements.
- 1B. Submit supporting documentation showing the eligibility, reasonableness, and allocability of \$1,829,165 charged to the Block Grant program for payroll expenses that were not properly accounted for in the Municipality's accounting records and for \$422,393² in administrative expenses and other activity-related costs that were not properly supported or reimburse the program from non-federal funds.
- 1C. Charge the Block Grant program only for the lease space directly used for the administration and carrying out of program activities.
- 1D. Provide financial management-related training to its accounting staff and improve its oversight of the financial management system processes.

² Amount includes \$385,164 of rent charges between July 2009 and June 2012, and \$37,228 charged to the Block Grant program, associated with administrative and other activity related expenses paid between July 2009 and August 2011.

Finding 2: The Municipality Did Not Support Certain Activity Costs

The Municipality charged to the Block Grant program more than \$1.6 million as activity costs associated with wages without supporting the basis and reasonableness of the charges and how these costs were directly related to carrying out the activities. These deficiencies occurred because the Municipality disregarded HUD requirements. As a result, HUD lacked assurance that costs charged to the Block Grant program were allowable, allocable, and reasonable.

Unreasonable Activity Costs

Between July 13, 2007, and July 6, 2012, the Municipality charged an average of 48 percent, or \$1.8 million, of the Block Grant funds awarded for carrying out housing rehabilitation and public facility improvement activities as activity costs for the wages of Municipality employees. These activities were mainly associated with the repair and construction of roads, the improvement of recreational facilities, and assistance to local citizens in the rehabilitation of their homes. In six of the seven activities, the construction work was performed by private contractors, but the Municipality also charged the wages of municipal employees who did not perform any work related to the activity. For example, activity 1036 was charged about 69 percent in questionable payroll costs. Further, in activity 1128, the Municipality charged the Block Grant program more than \$257,000 in activity delivery costs when no street resurfacing efforts had taken place.

IDIS* activity number	Activity name	Total Block Grant funds drawn from HUD system as of July 6, 2012	Amount of salaries charged as delivery costs	Percentage of the activity expenditures charged as delivery costs
922	Street improvement	\$709,561	\$322,309	45
878	Basketball court improvement Bo. Obrero	\$179,191	\$36,685	20
1036	Street improvement	\$361,784	\$252,553	69
1081	Street improvement	\$447,332	\$241,922	54
1128	Street improvement	\$257,915	\$257,905	100
Various ³	Housing rehabilitation	\$1,853,913	\$760,655	41
877	Basketball court improvement Bo. Jaraelito	\$178,487	\$22,994	13
	Total	\$3,988,183	\$1,895,023	48

*HUD's Integrated Disbursement and Information System

The Municipality, as explained below, charged ineligible and unsupported program delivery costs to these activities.

³ Activities include 651, 874, 923, 1021, 1022, 1033, 1080, and 1130.

Ineligible Activity Delivery Cost

Between August 5, 2008, and July 6, 2012, the Municipality charged more than \$552,000 in program delivery costs to six Block Grant activities for the full wages and fringe benefits of 17 Municipality employees who did not perform duties or responsibilities directly related to carrying out such activities. These employees were assigned to other Block Grant-funded activities that were not related to the activity charged with the cost. Regulations at 24 CFR 570.206 allow the disbursements for eligible activity costs, including staff and overhead costs directly related to carrying out the activity. In addition, a cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with the relative benefits received (2 CFR Part 225, appendix B, section C.3a). The Municipality did not ensure that costs charged to the Block Grant program were directly related to carrying out the chargeable activities and charged the cost of public service-related activities to other activities to avoid a 15 percent threshold expenditure limitation established by HUD under the Block Grant program.⁴ Therefore, more than \$552,000 in costs charged to these activities was considered ineligible.

Unsupported Activity Delivery Costs

Program delivery costs charged to the Block Grant program were not properly supported by source documents or incurred according to all of the applicable requirements. The Municipality charged more than \$1 million to six Block Grant activities as program delivery costs between August 5, 2008, and July 6, 2012, without ensuring that costs were allocated in accordance with Federal requirements; therefore, these costs were questionable. The Municipality disbursed the funds for the salaries and fringe benefits of 15 employees, who either performed local government duties while also assigned to perform work for the Block Grant program or worked in multiple Block Grant program activities, without properly allocating the cost among the activities. Although it charged the Block Grant program the full payroll costs associated with these employees, it did not maintain documentation to support the basis of the allocation and the reasonableness of the costs as required by 2 CFR Part 225, appendix B, item 8.h.(4).⁵ Therefore, HUD lacked assurance of the reasonableness, allowability,

⁴ The Community Development Block Grant Guide, chapter 7.2, requires that the total amount of Block Grant funds obligated for public service activities must not exceed 15 percent of the annual grant allocation plus 15 percent of program income received during the prior year.

⁵ Regulations at 2 CFR Part 225, appendix B, item 8.h.(4), requires that when employees work on multiple activities or cost objectives, distribution of their salaries or wages be supported by personnel activity reports, an equivalent documentation, or other substitute system that has been approved by the cognizant Federal agency.

and allocability of more than \$1 million in payroll costs charged to the Block Grant program.

Disregard for Requirements

The Municipality disregarded HUD requirements and instructions to ensure that it charged all of its program delivery costs appropriately. Municipality officials acknowledged that because of financial constraints and to avoid local budget shortfalls, the Municipality knowingly charged the salaries of employees who were working for the local government to activities funded with Federal funds. Officials also stated that the salaries of some employees working in the La Posada Homeless activity were charged to street improvement activities to avoid exceeding the 15 percent limit threshold established by HUD regulations for a public service activity.

Conclusion

The Municipality improperly charged to the Block Grant program the salaries of employees who did not perform duties directly related to carrying out the funded activities or performed other functions not related to the Block Grant activity charged without adequately allocating the cost. It did so to subsidize local government activities and to avoid exceeding the public services (15 percent) threshold expenditure limitation established under the Block Grant program. As a result, HUD had no assurance that costs charged to the activities as program delivery costs were allowable and reasonable.

Recommendations

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

- 2A. Require the Municipality to reimburse from non-federal funds \$552,658 in unallowable and unallocated costs associated with the disbursement of salaries and fringe benefits of employees who did not perform duties directly related to carrying out activities charged with the program delivery costs.
- 2B. Require the Municipality to provide support showing the allocability and eligibility of \$1,077,577 spent on salaries and fringe benefits for employees who performed local government duties and multiple federally funded activities without properly allocating the costs directly related to carrying out each activity. Any amounts determined ineligible must be reimbursed to the Block Grant program from non-federal funds.

- 2C. Require the Municipality to ensure that only eligible program delivery costs are charged to the Block Grant program.
- 2D. Require the Municipality to discontinue charging program delivery cost to activities that are not public services related activities in order to avoid the 15 percent threshold expenditure limitation established under the Block Grant Program.

Finding 3: The Municipality Did Not Support Its Reported Housing Rehabilitation Accomplishments and National Objectives

The Municipality did not support the reported accomplishments of its housing rehabilitation efforts and did not demonstrate compliance with Block Grant national objectives of its street improvement activities. These deficiencies occurred because the Municipality did not have in place a tracking system for its housing efforts and was not aware of all HUD requirements. As a result, HUD had no assurance that reported accomplishments were accurate and program objectives were met.

Unsupported Accomplishments

The Municipality awarded to local citizens \$882,909 in Block Grant funds for housing rehabilitation efforts between July 1, 2009, and June 30, 2011. During this period, it reported to HUD that it had completed the rehabilitation work for more than 215 dwelling units. However, Municipality management did not maintain adequate internal controls to track and support the accomplishment of its rehabilitation activities. As a result, HUD had no assurance that program objectives were met or that reported accomplishments were accurate.

The Municipality reported in its 2009 annual performance report that a total of 97 dwelling units had been rehabilitated. However, the Municipality's records reflected that only two units had been completed. The Municipality's housing rehabilitation accomplishments included in the 2010 annual performance report were also unsupported. The Municipality reported that 118 dwelling units were rehabilitated between July 2010 and June 2011, but its records reflected that only 28 had been completed. Therefore, the Municipality reported to HUD inaccurate information, and HUD had no assurance that program objectives were met.

The Municipality also did not properly monitor its housing rehabilitation efforts to ensure the timely completion of the rehabilitation work. Its housing rehabilitation guidelines established that the rehabilitation work must be completed within 120 days after construction materials are delivered to the program participants. The Municipality approved assistance to 299 participants between July 2009 and December 2011. However, it did not ensure that program guidelines were followed when the rehabilitation work was completed within the established timeframe (120 days) in only nine units. In 182 of the 299 approved cases (61 percent), the rehabilitation was completed between 406 and 855 days after the assistance was granted. As a result, the rehabilitation of these units was not completed in a timely manner.

The Municipality did not have in place an adequate tracking system to show the total assistance provided to each participant, the status of the repair work, the dwelling units with due inspections, or the participants with undelivered

materials. The Municipality would have to review each individual case file to obtain or extract the above-mentioned data. Further, the housing rehabilitation director informed us that between 30 and 40 percent of the materials purchased were not used because participants did not complete the repair work. Therefore, HUD had no assurance that Block Grant program objectives were met.

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

Material going to waste - In May 2012, we visited 10 program participant residences to determine whether repairs had been completed. Our visits identified two participants that had received materials valued at \$8,624 but had performed no work. Some of the materials were on the property and were going to waste.



Materials going to waste



Incomplete workmanship

Inspection process inadequate - The Municipality had not inspected 268 of the 299 cases approved for rehabilitation assistance. The Municipality's housing rehabilitation guidelines provided that assisted dwelling units would be inspected to ensure the use of the materials provided to participants and the adequacy of rehabilitation work. Once materials were delivered, the Municipality was to conduct progress inspections every 60 days until the repair work was completed and a final inspection was conducted. A Municipality official informed us that there was a shortage of personnel to perform the required inspections in a timely manner. The Municipality supported only \$65,597 in disbursements associated with 28 housing units that were found to have been completed during their field inspections.

Missing work specifications - The Municipality did not prepare detailed work write-ups or specifications of the rehabilitation work needed. The files contained only a general statement from the Municipality's inspector. The files did not clearly demonstrate the type of repair needed to bring the unit up to program standards. It contained a general description that did not clearly demonstrate the scope of the rehabilitation needed. As a result, the files did not properly support the needed repairs, and the completed work assisted with Block Grant funds could not be determined.

Preexisting housing quality standards deficiencies not addressed - The Municipality did not follow its own policies and procedures when providing Block Grant assistance by not addressing all preexisting code violations. The Municipality's housing rehabilitation program guidelines required that all repairs must fulfill basic and indispensable needs so that the unit provides a secured dwelling and a better living condition. The guidelines also provided that all housing rehabilitation work approved under the program must comply with Federal, State, and municipal regulations and requirements. OIG inspections revealed that in one unit, classified as completed by the housing inspector, the Municipality did not provide sufficient assistance to ensure that the unit complied with its housing quality standards. The violations included that the (1) unit had no running water or electricity, (2) kitchen and bathroom had not been completed, and (3) back door had no stairs or rails.

Unsupported National Objectives Compliance

The Municipality disbursed more than \$410,000 in Block Grant funds between November 2008 and August 2011 for two activities associated with the reconstruction and pavement of roads throughout the Municipality without supporting whether the activities complied with a national objective⁶. It mainly reported to HUD that the activities met the national objective of benefiting low- and moderate-income persons based on the area benefit subcategory and the 2000 census. Although most of the roads were located in census blocks of low- and moderate-income persons as determined by the 2000 census, the area served by the activity was limited to a few census block groups surrounding the area in which it was located. For example, roads were constructed or resurfaced for the benefit of between 2 to 40 families, whereas the number of persons residing in the blocks used to determine the national objective was between 765 and 2,967.

The Municipality, therefore, did not, as required by 24 CFR 570.208 (a)(1),⁷ properly determine the service area before Block Grant assistance was provided to repair streets that would usually benefit only residents of the immediately adjacent area. Therefore, the Municipality did not properly document whether the activity complied with a national objective by not demonstrating how the served area benefited only low- and moderate-income persons.

⁶ According to HUD guidance (24 CFR 570.483), to qualify for Federal funding, every Block Grant-funded activity must meet one of the following three national objectives; (1) benefiting low- and moderate-income persons, (2) preventing or eliminating slums or blight, and (3) meeting an urgent needs having a particular urgency because existing conditions pose a serious and immediate threat to the health or welfare of the community.

⁷ Regulations at 24 CFR 570.208(a)(1) require that area benefit activities be available to all of the residents in a particular area where at least 51 percent of the residents are low- and moderate-income persons. Such an area need not be coterminous with census tracts or other officially recognized boundaries but must be the entire area served by the activity.

We also noted instances in which the Municipality did not properly document how it determined its street improvement activities' compliance with national objectives, including inconsistent or missing information regarding the boundaries of the service area, percentage of low- and moderate-income persons in the service area, and number of families benefited. Information reported to HUD in its information system was also not consistent with the Municipality's records in relation to the blocks served with the activity. Further, we found instances in which the Municipality did not maintain evidence of compliance with a national objective in service areas where less than 51 percent of persons were not low- and moderate-income persons as determined by the 2000 census.

Private Properties Repaved

In October 2012, we performed site inspections of 11 street resurfacing projects funded with Block Grant funds. The Municipality improperly paid from Block Grant funds for the road resurfacing private properties. During our visit, we noted that six private properties had been paved with HUD funds. The OIG inspections showed that there were road resurfacing projects for which construction or resurfacing work included private driveways or roads to residences that appeared to be private property instead of municipal roads, and were recorded as improvements to public facilities





A Municipality official informed us that he did not know that private properties were resurfaced since it was not permitted and that the Municipality did not require residents to provide evidence that the roads to be constructed or resurfaced were in public domain.⁸

Conclusion

The Municipality did not support the accomplishments of its housing rehabilitation efforts and did not demonstrate compliance with Block Grant national objectives in its street improvement activities. Therefore, not all of the reported program accomplishments could be supported, and \$817,312 in funds awarded for these efforts was considered unsupported pending an eligibility determination by HUD. In addition, the Municipality did not support whether \$410,221 in Block Grant funds disbursed for road resurfacing activities was for a HUD-approved national objective and for eligible purposes. The deficiencies occurred because the Municipality did not have in place an adequate tracking system that could show the total assistance provided to each participant, the status of the repair work, and the housing rehabilitation cases inspected. The Municipality was also not fully aware of all of HUD's Block Grant national objective requirements. As a result, HUD lacked assurance that Federal funds drawn down for housing rehabilitation and street improvement efforts met program objectives, Block Grant funds were used solely for authorized purposes, and reported accomplishments were accurate.

Recommendations

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

⁸ HUD informed us that under the public facilities and improvements activity type the construction or resurfacing work of private driveways or roads to residences in private property is not allowable.

- 3A. Require the Municipality to submit all supporting documentation showing the current status of the repair work and the eligibility and propriety of \$817,310⁹ for housing rehabilitation activities or reimburse the Block Grant program from non-federal funds.
- 3B. Require the Municipality to submit supporting documentation evidencing how Block Grant funds in the amount of \$410,221 disbursed for street improvements benefited low- and moderate-income persons in accordance with HUD requirements or reimburse the Block Grant program from non-Federal funds.
- 3C. Require the Municipality to determine the amount expended for the resurfacing of all private properties and reimburse the Block Grant program from non-federal funds.
- 3D. Require the Municipality to implement an adequate tracking system for housing rehabilitation activities that can accurately show the status of the repair work for each assisted dwelling unit and maintain adequate staffing to ensure that unit inspections are conducted as required by its policies and procedures.
- 3E. Require the Municipality to ensure that Block Grant funds are used for activities meeting a national objective and for eligible purposes, that they are properly supported, and that staff are aware of all of the HUD's Block Grant national objective requirements.

⁹ Questioned amount consists of \$882,909 in housing rehabilitation awards made by the Municipality minus \$65,599 in disbursements associated with 28 housing units that were found to have been completed during field inspections.

Finding 4: The Municipality's Procurement Procedures Had Weaknesses

Generally, the Municipality complied with requirements for planning, soliciting, and awarding contracts and purchase orders. However, it failed to perform a required cost analysis in one contract, and in all four contracts reviewed, it did not follow all of HUD's regulations in regards to maintaining adequate documentation of the procurement history. In addition, the Municipality did not ensure that contracts included all of the provisions required by Federal regulations. The conditions occurred because of the Municipality's inadequate knowledge of HUD requirements and deficient written policies and procedures. As a result, the Municipality did not support the reasonableness of more than \$124,000 awarded in a contract.

Procurement Deficiencies in Contracts Reviewed

We analyzed four contracts awarded between July 1, 2009, and June 30, 2012, totaling more than \$1.6 million. The Municipality generally showed that it procured services in a manner that provided, to the maximum extent practical, open and free competition; however, there was at least one procurement deficiency in all contracts reviewed.

For example, the Municipality did not always

- Maintain adequate support to demonstrate that it provided potential contractors with complete and adequate specifications of the scope of services to be performed and adequate bid forms.
- Ensure that contracts included all provisions required by 24 CFR 85.36(i). For example it did not include provisions related to (1) providing HUD, the Comptroller General of the United States, or any of their duly authorized representatives access to any books, documents, papers, and records of the contractor, which are directly pertinent to the specific contract for the purpose of making audit, examination, excerpts, and transcriptions, and (2) mandatory standards and policies relating to energy efficiency, which are contained in the State energy conservation plan issued in compliance with the Energy Policy and Conservation Act and
- Prepare an independent cost or price analysis to determine the reasonableness of the charges.

The following table contains a list of the procurement deficiencies found during the review.

Contract information		Deficiencies				
Award	Amount	No cost or price analysis	Missing or inadequate specifications of services solicited	Bid package not properly documented	Missing contract provisions	Did not follow Municipality procurement regulations
Interactive fountain	\$1,047,480		X		X	X
Hato Viejo Community Center	\$284,376			X	X	
Town Square improvements	\$239,995			X	X	X
Landmarks	\$124,200	X		X	X	X

Outdated Policies and Procedures

The Municipality’s written procedures did not fully conform to applicable Federal standards and contained inconsistencies. According to Municipality officials, the policies and procedures used during their procurement process included the Municipality’s procurement regulations. They also used the less restrictive regulations of the Office of Commissioner for Municipal Affairs that the municipalities of Puerto Rico must follow when procuring goods and services. These policies and procedures contained inconsistencies regarding when the small purchase method could be used in the procurement process and in publicly advertised sealed bid procurements in which only one bid was received from potential contractors.

Municipality officials stated that the threshold used when using the small purchase method¹⁰ had been changed in the past from \$40,000 to \$100,000 and that the policy of the Municipality in this regard was obsolete. In addition, the Municipality’s procurement regulations were changed in all open sealed bid procurement actions in which only one bid was received in the process. In these cases, the Municipality’s regulations required procurement officials to perform a second public bid when only one bid was received in the initial publicly open sealed bid process; whereas, in the Office of Commissioner for Municipal Affairs regulation, it was not a requirement. Municipality officials explained that procurement procedures were carried out selectively because State law allowed it and because the Municipality considered its Bid Board Regulation to be obsolete.

¹⁰ Small purchase method 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 established by the Municipality. If small purchase procedures are used, price or rate quotations shall be obtained from an adequate number of qualified sources.

The Municipality, as required by its written regulations, did not perform a second bid on three occasions and used the small purchase method instead of the sealed bid method in six of the eight contracts reviewed.

Municipality officials did not provide written evidence of who authorized the procurement procedural changes, when these changes went into effect, or whether the changes were implemented by an authorized Municipality official or a governing body. Therefore, they may have arbitrarily changed their policies and procedures to be less restrictive without the proper authorization, allowing the use of procurement methods that may have been less competitive among potential bidders.

In addition, both procurement policies and procedures did not conform to the following applicable Federal standards¹¹:

- Maintaining written procedures for the conduct of small purchases.
- Maintaining a written code of conduct governing the performance of their employees engaged in the award and administration of contracts.
- Maintaining written procedures that provide for a review of proposed procurements to avoid the purchase of unnecessary or duplicative items.
- Maintaining procurement selection procedures to ensure that all solicitations (1) incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured and (2) identify all requirements which the offerors must fulfill and all other factors to be used in evaluating bids or proposals.

Conclusion

Generally, the Municipality complied with HUD procurement requirements when it awarded contracts. However, there was a material noncompliance in the procurement of one construction contract, and the Municipality's policies and procedures did not always conform to applicable Federal standards. The Municipality could improve its procurement process by revising its procurement policies and procedures and consistently performing required cost analysis to ensure that goods and services are obtained under the most advantageous terms.

¹¹ Federal citations are included in 24 CFR 85.36 (b) (3-4) and (c) (3).

Recommendation

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

- 4A. Submit supporting documentation showing the reasonableness of \$124,200 charged to the Block Grant program in relation to procurement for the construction of landmarks or reimburse the program from non-federal funds.

- 4B. Revise its policies and procedures to ensure that it contains (1) written procedures for the conduct of small purchases, (2) a written code of conduct, (3) procedures for a review of the proposed procurements, and (4) procedures to ensure that all solicitations incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured and identify all requirements which the offerors must fulfill and all other factors to be used in evaluating bids or proposals .

SCOPE AND METHODOLOGY

The objective of the audit was to determine whether the Municipality complied with HUD regulations, procedures, and instructions related to the administration of the Block Grant program. Specifically, we evaluated whether (1) its financial management system complied with HUD requirements, (2) it disbursed Block Grant funds for allowable and supported costs, (3) funded activities met national objectives, and (4) it followed HUD's and its own procurement requirements.

To accomplish our objective, we

- Reviewed applicable HUD laws, regulations, and other HUD program requirements;
- Reviewed the Municipality's controls and procedures as they related to our objectives;
- Interviewed HUD and Municipality officials;
- Reviewed monitoring, independent public accountant, and HUD's information system reports;
- Reviewed the Municipality's files and records, including activity files and financial records;
- Traced information reported in HUD's information system to the Municipality's records; and
- Performed site inspections of the activities.

We reviewed a sample of transactions based on the dollar amount, and/or on nature of the expenditure; examining 100 percent of the transactions were not feasible. The results of the audit apply only to the items selected and cannot be projected to the universe or population.

HUD's information system reflected that the Municipality withdrew more than \$3.6 million in Block Grant funds up to December 31, 2011, for 24 public facilities and improvement activities that had disbursements during our audit period. We selected and reviewed activities with amounts greater than \$120,000 and based on the type of activity. The sample resulted in six activities totaling more than \$1.5 million (42 percent) in Block Grant funds withdrawn. The activities were reviewed and inspected to determine whether funded activities met at least one national objective and whether the Municipality disbursed Block Grant funds for allowable and supported costs. Based on deficiencies noted regarding the propriety of funds charged as delivery costs, we also reviewed withdrawals totaling more than \$752,000 made between August 4, 2009, and July 11, 2012, that were associated with three additional activities.

The Municipality's records reflected that between July 1, 2009, and December 31, 2011, it disbursed more than \$1.3 million in planning and administration costs. For each fiscal year ending June 30, we selected for review the month with the highest disbursed amount. The sample resulted in the review of planning and administration costs totaling more than \$229,000 associated with the months of September 2009, November 2010, and August 2011. The expenditures and related supporting documents were reviewed to determine whether the payments met Block Grant requirements, including allowability and allocability of the costs.

We obtained a list of housing rehabilitation cases funded with Block Grant funds between July 1, 2009, and December 31, 2011. During this period, the Municipality awarded Block Grant funds

totaling more than \$882,000 associated with 299 housing rehabilitation assistance cases. From this list, we reviewed 10 activities with awards totaling more than \$56,000. They represented, according to Municipality records, the five completed activities and the five in-progress activities with the highest awarded amount. Total amounts reviewed represented 6.3 percent of the total awards. We reviewed and inspected each activity to verify participant eligibility, the status of the rehabilitation work, and the appropriateness of the assistance provided. We also reviewed the Municipality's 2009 and 2010 annual performance reports to assess whether its records adequately supported reported program accomplishments.

We obtained lists of the Municipality's Block Grant procurement efforts that were performed between July 1, 2009, and June 30, 2012. We selected procurement actions outside of the general audit scope period of July 1, 2009, and December 31, 2011, to ensure that the procurement actions selected were recently performed. The Municipality conducted six procurement actions, following the formal advertising method, totaling more than \$1.9 million and 11 construction-related procurement actions, following the small purchase procedures, totaling more than \$589,000. We selected and reviewed the formal advertising procurement actions with awarded amounts greater than \$200,000 and the small purchase procurement actions with awards greater than \$30,000. We also reviewed the procurement of a contract totaling more than \$124,000 for the design, construction, and installation of community landmarks based on indications of possible deficiencies. The sample resulted in four procurement actions, requiring formal advertising, totaling more than \$1.6 million and eight procurement actions, through small purchase procedures, totaling more than \$547,000. We reviewed each procurement action to determine whether the procurement process used by the Municipality followed its own policies and procedures and met HUD standards.

We did not consider the Municipality's accounting records reliable for our purposes because they did not reflect complete and accurate financial information on program activities. To achieve our audit objectives, we relied in part on computer-processed data contained in the Municipality's database and 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. Testing for reliability included the tracing of data from the Municipality's accounting system to their physical files.

The audit generally covered the period July 1, 2009, through December 31, 2011, and we extended the period as needed to accomplish our objectives. We conducted our fieldwork from March through November 2012 at the Municipality's offices in Arecibo, 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

INTERNAL CONTROLS

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

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

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

Relevant Internal Controls

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

- 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's financial management system did not comply with HUD requirements (see finding 1).
- The Municipality did not support certain activity costs (see finding 2).
- The Municipality did not support its reported housing rehabilitation accomplishments and national objectives (see finding 3).
- The Municipality's procurement procedures had weaknesses (see finding 4).

APPENDIXES

Appendix A

SCHEDULE OF QUESTIONED COSTS

<u>Recommendation number</u>	<u>Ineligible^{1/}</u>	<u>Unsupported ^{2/}</u>
1B		\$2,251,558
2A	\$552,658	
2B		1,077,577
3A		817,310
3B		410,221
4A		<u>124,200</u>
Total	<u>\$552,658</u>	<u>\$4,680,866</u>

- 1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local 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



Estado Libre Asociado de Puerto Rico
GOBIERNO MUNICIPAL DE ARECIBO
DEPARTAMENTO DESARROLLO MUNICIPAL
La Villa del Capitán Correa

Hon. Carlos Molina Rodriguez, Alcalde

February 13, 2013

Nikita N. Irons
Regional Inspector General for Audit
Attention: Mr. Michael Rivera
US Department of Housing and Urban Development
Office of Audit, Region 4
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

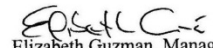
Dear Ms. Irons:

We are submitting comments to the draft audit report for the CDBG program of the Municipality of Arecibo.

Ever since receiving your January 29, 2013 letter we have been, as per Mayor Molina's instructions, actively involved in reviewing the findings of the report and gathering all relevant information that would allow us to submit appropriate comments. However, as a new Administration, we are currently facing considerable challenges in collecting all the necessary documentation due to the still-ongoing Municipal transition process and the fact that the findings in the draft report cover the management of the Municipality's CDBG Program under a previous Administration.

In order to expedite this process, my staff and I are working diligently to make sure that we have access to the complete financial records pertaining to the Arecibo CDBG Program and related activities for the years covered by the audit. Although at this point we are still unable to submit to your office a complete and thorough list of comments and observations in response to the findings in the draft audit, we would like to respectfully request until February 28, 2013 to adequately submit the supporting documentation for all findings.

Sincerely,


Elizabeth Guzman, Manager
CDBG Program Municipality of Arecibo

P.O. Box 1086 Arecibo, Puerto Rico 00613 • Tel. (787) 878-2770 • 878-9254

Finding #1 The Municipality's Financial Management System Did Not Comply with HUD Requirements

Inadequate Accounting Records

- The Municipality did not maintain a general ledger for the Block Grant Program.

Comment 1

Comment: The Municipality has already acquired a new Financial Management System and has begun training its Financial and Accounting Divisions' staff on its proper use in accordance with HUD requirements.

- The Municipality's accounting records did not reflect the disposition of more than \$1.8 million for the Block Grant program.

Comment 1

Comment: We are currently scrutinizing the disposition of the funds so as to provide HUD with the required evidence on how they were invested.

Unsupported Program Disbursement

- The Municipality charged the Block Grant program the full lease cost of its office space, although part of the space was occupied by a division that performed general government activities not associated with the Block Grant program.

Comment 2

Comment: We would like to point out that 51 of 52 employees located in rented space, carry out tasks related to the CDBG program. This represents a 98 percent of the space is occupied by personnel performing tasks related to CDBG. Furthermore, this government, no federal-funded division is in moving process, so for the new program year or early will no longer be occupying a space.

Lack of Training and Inadequate Oversight of Financial Management Processes

- Lack of training and inadequate oversight of Financial Management Processes

Comment 1

Comment: As mentioned above, the Municipality has already acquired a new Financial Management System and has begun training its Financial and Accounting Divisions' staff on its proper use in accordance with HUD requirements.

Finding #2 The Municipality did not support certain activity costs

Comment 3

- Unreasonable Activity Costs

Comment: We have initially found that most, if not all, of the instances referenced in the draft audit were carried out by independent contractors that the Municipality hired after successfully going through a procurement/bidding process. Our inquiry into these findings reflects that the amounts charged to the Block Grant Program were used to cover for the wages of Municipal employees and personnel that were responsible for supervising and inspecting the public services work performed by the outside contractors.

- Ineligible Activity Delivery Cost

The Municipality charged more than \$552,000 in program delivery costs to six Block Grant activities for the full wages and fringe benefits of 17 municipality employees who did not perform duties directly related to carrying out such activities.

Comment 4

Comment: The Municipality will cease and desist to pay wages and fringe benefits to employees who do not perform duties related to CDBG activities to avoid a 15 percent threshold expenditure limitation established by HUD.

The Municipality will have to establish a payment plan with HUD to reimburse the disallowed costs.

- Unsupported Activity Delivery Costs

Comment 5

Comment: All employees carry out tasks related to CDBG funds although some of their salaries are paid as delivery costs for CDBG activities funds and other from non-federal funds. Each and every one of them carries out duties directly related to the activities, even when their salaries are being paid from municipal funds.

As recommended, the Municipality will ensure that only eligible program delivery costs are charged to the Block Grant program and will discontinue charging program delivery costs to activities that are no public services related activities in order to avoid the 15 percent threshold expenditure limitation established under the Block Grant program.

Finding #3 The Municipality Did Not Support Its Reported Housing Rehabilitation Accomplishments and National Objectives

- **Unsupported Accomplishments**

Comment 6

Comment: Based on our preliminary investigation it appears that the rehabilitated dwelling units that were reported by the Municipality as completed were those to which construction materials were provided for their rehabilitation, but not necessarily those where all the actual rehabilitation had been accomplished. The Municipality is currently undergoing an effort to certify the completion of the rehabilitation efforts in these units and close the cases where the works has been completed. We are also in the implementation stages of a new monitoring system to ensure that all dwelling rehabilitation efforts are completed within a 120-day period, and to provide assistance through Municipal construction crews in those cases where it's deemed necessary in order to meet the deadline.

- **Unsupported National Objectives Compliance**

Comment 7

Comment: The Municipality has always strived to determine the eligibility of said activities based on the Decennial Census and on the activity in question benefiting an area where at least 51 percent of the population is low-income. Also, we have found no evidence, to date, that any private properties were resurfaced using funds from the Block Grant program. That being said, the Municipality is prepared and willing to work with HUD to ensure that Block Grant funds are used for activities meeting a national objective and for eligible purposes, and that they are properly supported and staffed.

As a corrective measure the Municipality will establish the area to be served and/or benefited as is done with the Census tract and carry out a socioeconomic study to determine the income of the immediate households surrounding the street to be repaved and ensured to meet the National Objective of benefiting low and moderate income persons.

The Municipality has oriented the citizens about the resurfacing in private properties is ineligible and prohibited under Block Grant funds and the personnel appointed to inspect and supervise the works of pavement are aware of this. In the eventuality that an activity of resurfacing appeared be a private property, this could be because the contractor has decided, after finishing resurfacing the road in its entirety, repave some private entrance to residence with the left over from asphalt.

Finding 4: The Municipality's Procurement Procedures Had Weaknesses

- **Procurement Deficiencies in Contracts Reviewed**

Comment 8

Comment: The municipality governs its bidding process according to Law # 81 (Autonomous Municipalities Act). In the contract subject of this finding the Municipality held a pre-auction attended by three bidders and one subsequently withdrew. Only one bidder attended the auction, which was awarded the auction. According to the Autonomous Municipalities Act, the City may declare void the auction and make a second auction or award the same to the tenderer who participated, which was what happened in the award of this auction. As for the contract provisions (Comptroller General of U.S., and Energy Efficiency) the municipality has always adjusted contracts awarded and paid with federal funds to comply with all the terms such as Davis Bacon Act or clauses required for ARRA. The municipality had no knowledge of these terms and has no objection to immediately implement them.

OIG Evaluation of Auditee Comments

Comment 1 The Municipality stated that it has acquired a new financial management system and has commenced training its staff. The Municipality also stated that it will provide HUD with the necessary evidence showing the disposition of the \$1.8 million Block Grant program funds.

We acknowledge the Municipality's efforts to improve its financial management system. It will need to show HUD that its financial system adequately permits the tracing of program receipts and expenditures and ensures that all funds were adequately accounted for, safeguarded, and used for requested and eligible purposes and in accordance with the Block Grant program.

Comment 2 The Municipality stated that 51 of the 52 employees located in the rented space carried out tasks related to the Block Grant program; therefore, 98 percent of the rented space was dedicated to the Block Grant program. The Municipality also stated that the non-Federal division will move from the current location.

The Municipality did not address the fact that the employees working in the division were also performing general government activities not associated with the Block Grant program. Accordingly, the lease cost needed to be properly allocated in accordance with 2 CFR 225. The Municipality also did not provide additional documentation showing the allowability and reasonableness of the lease costs. In addition, the Municipality did not address the \$36,915 associated with administrative and other activity-related expenses that were unsupported. Therefore, we did not modify the report finding and recommendation.

Comment 3 The Municipality stated that Block Grant funds were used to pay for the wages of employees responsible for supervising and inspecting the public services work performed by private contractors.

As discussed in the report, the Municipality charged an average of 48 percent, or \$1.8 million, in Block Grant funds for carrying out housing rehabilitation and public facility improvement activities as activity costs for the wages of municipal employees. However, the Municipality did not provide additional support that could demonstrate the allowability and reasonableness of the costs incurred.

Comment 4 The Municipality stated that it will stop charging the Block Grant program for the wages and fringe benefits of employees not associated with the program and that it will work on a payment plan with HUD to reimburse the ineligible costs.

Comment 5 The Municipality stated that all employees carry out tasks related to the Block Grant program, although parts of their salaries are paid with non-Federal funds. It also stated that it will ensure that only eligible delivery costs are charged to the program.

As discussed in the report, the Municipality disbursed Block Grant funds for salaries and fringe benefits of employees who performed local government duties while also assigned to perform work for the Block Grant program without properly allocating the costs among the activities. Although the Municipality claims that parts of the salaries were paid with non-Federal funds, it did not provide additional documentation to substantiate its claim. Therefore, we did not modify the report finding and recommendations.

Comment 6 The Municipality stated that the units reported to HUD as rehabilitated were those to which assistance was provided but for which the repair work had not necessarily been completed. The Municipality also stated that it was in the process of certifying and closing the cases in which the rehabilitation was completed and that it was implementing a new monitoring system to ensure that all dwelling rehabilitation efforts are completed within 120 days.

We acknowledge the Municipality's efforts to improve its housing rehabilitation monitoring efforts. The Municipality will need to provide HUD documentation showing that it has established and implemented a tracking system that can accurately show the status of the repair work. In addition, it will need to provide HUD with documentation supporting the eligibility and propriety of its housing rehabilitation efforts.

Comment 7 The Municipality stated that it found no evidence of private properties being resurfaced with the Block Grant funds. It also stated that if a private property was paved, it was because of the initiative of the private contractor after completing the work for the contracted road. In addition, the Municipality stated that to ensure compliance with the national objective of benefiting low- and moderate-income persons, it will perform socioeconomic studies of the households immediately surrounding the streets to be repaved.

As discussed in the report, the OIG inspections showed that there were road resurfacing projects for which construction or resurfacing work included private driveways or roads to residences that appeared to be private property instead of municipal roads. The possibility of private contractors doing additional work outside the scope of the contract raises concerns regarding the proper supervision by municipal inspectors and the purchasing of unnecessary materials that could result in a waste of Federal funds. The Municipality did not provide additional support that could demonstrate the eligibility and propriety of the disbursements associated with its street resurfacing efforts. Therefore, we did not modify the report finding and recommendation.

Comment 8 The Municipality stated that its bidding process was consistent with local regulations and that it was not aware of the contract clauses required by HUD.

The Municipality did not comment on the fact that it failed to perform a required cost analysis, it did not maintain adequate documentation of the procurement

history, and its written procedures did not fully conform to applicable Federal standards and contained inconsistencies. It did not provide additional documentation to sustain its claim. Therefore, we did not modify the report finding and recommendations.