



Issue Date	February 8, 2011
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Audit Report Number	2011-LA-1006
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TO: Maria F. Cremer, Acting Director, San Francisco Office of Community Planning and Development, 9AD

Tanya E. Schulze

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

SUBJECT: The City of Mesa, AZ, Needs To Improve Its Procedures for Administering Its Neighborhood Stabilization Program Grant

HIGHLIGHTS

What We Audited and Why

We audited the City of Mesa's (grantee) Neighborhood Stabilization Program (NSP1) grant.

The audit was started primarily because the Office of Inspector General's (OIG) audit plan includes objectives to review Housing and Economic Recovery Act grantees and because staff from the U.S. Department of Housing and Urban Development's (HUD) Office of Community Planning and Development raised general concerns about the nonprofit subgrantee selected by the grantee to administer housing counseling, downpayment assistance, and single-family housing acquisition and rehabilitation. The grantee awarded \$2.8 million (29 percent) of its more than \$9.6 million NSP1 grant to this entity.

The objective of the audit was to determine whether the grantee administered its NSP1 grant in accordance with HUD's program requirements.

What We Found

The grantee did not ensure that NSP1 program requirements were met. Specifically, it (1) did not implement adequate controls over construction contractor draw requests, (2) failed to ensure the eligibility of labor costs claimed by its subrecipient, (3) did not ensure that payment and performance bonds were obtained for construction contracts as required, (4) charged ineligible employee salary costs to the NSP1 grant, and (5) did not properly enforce the program's continued affordability requirements.

What We Recommend

We recommend that the Acting Director of the San Francisco Office of Community Planning and Development require the grantee to implement procedures to ensure that NSP1 requirements are met and reimburse its NSP1 grant for ineligible costs charged to the grant.

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 received the grantee's written response to the audit report on February 4, 2011. The grantee generally agreed with the audit report finding and described actions it has taken or plans to take to address the deficiencies outlined in the audit report

The complete text of the grantee's response can be found in appendix B of this report.

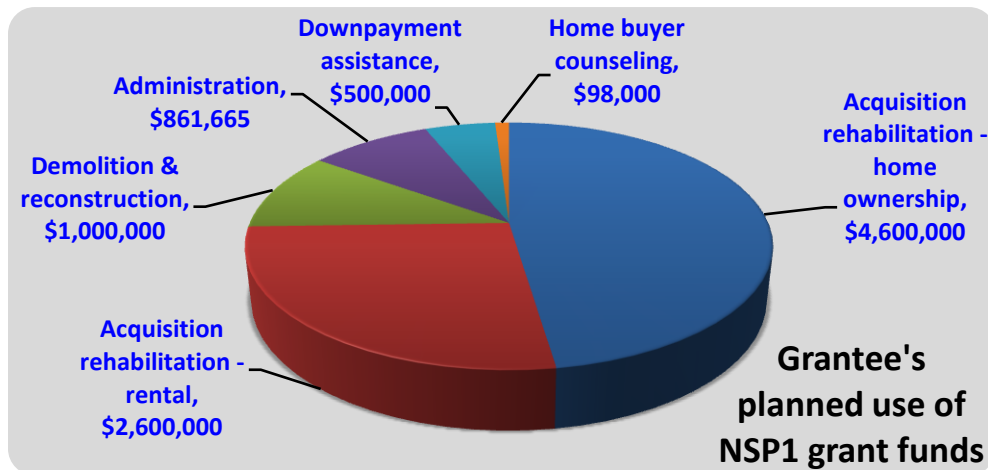
TABLE OF CONTENTS

Background and Objective	4
Results of Audit	
Finding: The Grantee Did Not Comply With NSP1 Requirements	5
Scope and Methodology	11
Internal Controls	12
Appendixes	
A. Schedule of Questioned Costs and Funds To Be Put to Better Use	13
B. Auditee Comments	14

BACKGROUND AND OBJECTIVE

The Neighborhood Stabilization Program (NSP1) was authorized under Division B, Title III, of the Housing and Economic Recovery Act of 2008 (HERA) and provides grants to all States and selected local governments on a formula basis. HERA appropriated \$3.92 billion in NSP1 funds for emergency assistance for redevelopment of abandoned and foreclosed-upon and residential properties. NSP1 was established for the purpose of stabilizing communities that have suffered from foreclosures and abandonment. Generally, the NSP1 funds must be used to buy, rehabilitate, and resell foreclosed-upon and abandoned homes. As long as the funds are used for this purpose, grantees may decide how to use the funds and what specific redevelopment activities to undertake.

The City of Mesa (grantee) was awarded approximately \$9.6 million in NSP1 grant funds. The grantee's planned use of the funds is shown in the chart below.



As of September 30, 2010, the grantee had drawn down more than \$4.7 million in NSP1 funds and \$562,656 in program income. The program funds drawn down represent 49.55 percent of the total grant.

The grantee's Neighborhood Services Department was in charge of administering its NSP1 activities. The grantee entered into a subgrantee agreement on July 29, 2009, with Housing Our Communities, a U.S. Department of Housing and Urban Development (HUD)-approved nonprofit housing counseling agency. The agreement awarded \$2.8 million of the grant to Housing Our Communities to manage the HUD-certified housing counseling and education portion of the program, manage the forgivable downpayment loan assistance portion of the program, and acquire and resell housing in partnership with the grantee.

The objective of the audit was to determine whether the grantee administered its NSP1 grant in accordance with HUD's program requirements.

RESULTS OF AUDIT

Finding: The Grantee Did Not Comply With NSP1 Requirements

The grantee's procedures for administering its NSP1 grant were not adequate to ensure that HUD's program requirements were met. The grantee (1) did not maintain adequate controls over construction contractor draw requests, (2) failed to ensure the eligibility of labor costs claimed by its subrecipient, (3) did not require payment and performance bonds for construction contracts as required, (4) charged unsupported employee salary costs to the NSP1 grant, and (5) failed to properly enforce the program's continued affordability requirements. These problems occurred primarily because the grantee's staff was not sufficiently familiar with the program requirements related to each deficiency and the grantee's procedures were not adequate to ensure that program requirements were met. As a result of the deficiencies, \$22,344 in NSP1 funds was used for ineligible expenses, and a portion of the grantee's NSP1 grant funds were at risk. Also, individuals who purchased rehabilitated homes from the grantee could be required to repay excessive amounts to release the grantee's liens if they attempt to sell their properties.

Controls Over Contractor Draw Requests Were Not Adequate

The grantee did not implement sufficient controls to ensure that payments to construction contractors were adequately supported. Grantee staff responsible for reviewing the draw requests estimated the percentage of project completion when approving draw requests and did not sufficiently document how the claimed amounts were validated. The draw requests did not include an updated schedule of values or other comparison of budgeted to actual amounts or activities completed to support the claimed percentage of work completed. The files did contain evidence of inspections by a grantee official; however, the documentation supporting these inspections did not include sufficient detail to support the claimed percentage of completion.

The grantee's procedures also did not require construction contractors to approve or certify the draw requests. The grantee prepared the draw documentation using forms that were signed by the contractors in advance. This procedure circumvented the contractor's signatory approval as a control procedure. These practices were not consistent with NSP1 program requirements including Office of Management and Budget (OMB) Circular A-87¹ and 24 CFR (Code of Federal Regulations) 85.20,¹ which require grantees to adequately document costs and maintain effective internal controls to protect grant

¹ Compliance with OMB Circular No. A-87, OMB Circular No. A-122, and 24 CFR 85.20 is required according to 24 CFR 570 subpart J, compliance with which is required according to the NSP1 notice (Federal Register Volume 73, Number 194, dated October 6, 2008).

assets. The procedures also did not comply with the grantee's written policies and procedures, which require its staff to validate the claimed percentage of construction completion for draw requests by checking off and totaling the amount of completed work using the line item budgeted values from the contractor's bid.

The grantee staff members responsible for processing the draw requests indicated that they were not aware that detailed information was required to support the percentage of completion claimed on draw requests. Because the documentation in the files was not adequate, supervisory or audit review of the draw request documentation could not readily determine whether the percentage of work claimed as completed was appropriately determined and reasonable. Therefore, HUD and the grantee did not have adequate assurance that payment amounts to construction contractors were determined appropriately. Additionally, if amounts claimed are not properly validated, it may create unnecessary risk to the program if contractors are paid prematurely and then fail to complete the associated work. At the time of our audit, the grantee had 17 construction contracts on NSP1 projects for amounts totaling \$1,929,959 that were not yet complete and would, therefore, be subject to additional risk due to this deficiency.

Subgrantee Salary Costs Were Not Supported

The grantee did not ensure that labor costs claimed by its subgrantee were determined in accordance with applicable cost principles. OMB Circular A-122¹ requires that subgrantees account for the actual costs incurred (including direct and indirect salary costs) to determine the amount that can be charged to the grant. This circular does not include provisions for charging profit or other increments above cost to Federal grants. The grantee did not ensure that these requirements were met since it agreed to hourly labor rates for subgrantee counseling and construction services but did not ensure that these rates were consistent with the subgrantee's actual costs. Grantee staff members stated that they were not aware that subgrantees were required to account for their actual costs. Further, it appeared that the amounts billed by the subgrantee for employee salary costs did not represent the subgrantee's actual cost for each employee. Information we received from the subgrantee indicated that its housing counselors who worked on the NSP1 grant were paid varying salaries; however, the hourly rates billed to the NSP1 grant were the same for each employee regardless of his or her salary amount. Therefore, it appeared that the amounts billed did not directly correlate to the subgrantee's actual cost for each employee.

Because the grantee approved draw requests for payment of subgrantee labor expenses without properly determining whether the costs were supported, HUD and the grantee did not have assurance that the costs were eligible under NSP1 program requirements. At the time of our audit fieldwork, the subgrantee had billed the NSP1 \$12,939 for counseling services and \$24,559 for acquisition services.

During the audit, we notified the grantee that its subgrantee labor costs did not appear to be adequately supported, and the grantee then requested additional labor cost detail from its subgrantee. The information provided was not sufficient to substantiate the amounts billed to the grant or to determine the amount of these expenses that was not eligible under NSP1 requirements. To determine the amount of ineligible subgrantee labor costs, the grantee would need to review detailed payroll documentation from its subgrantee, such as time cards and pay stubs, and compare the subgrantee's actual costs to the amounts charged to the grant.

The Grantee Did Not Require Payment and Performance Bonds

The grantee did not ensure that construction contractors obtained payment and performance bonds as required. For contracts that exceed the simplified acquisition threshold (set at \$100,000 during the audit period), HUD regulations at 24 CFR 85.36(h)² require that grantees obtain (1) a bid guarantee from each bidder equivalent to 5 percent of the bid price, (2) a performance bond on the part of the contractor for 100 percent of the contract price, and (3) a payment bond on the part of the contractor for 100 percent of the contract price.

The construction contracts for 10 of the grantee's NSP1 properties (totaling approximately \$1.7 million) exceeded the current simplified acquisition threshold, yet the grantee did not require contractors for these properties to obtain payment and performance bonds. This problem occurred because the grantee's staff was not familiar with the applicable program regulations. As a result, the grantee's NSP1-funded projects were at risk and could be subject to unnecessary costs or liens if subcontractors were not paid or if the contractors failed to complete the projects. This risk could be particularly significant for the grantee since, as noted above, the grantee did not have adequate controls to ensure that the percentage of work claimed as part of the draw requests was properly supported. At the time of our audit, construction work was still in progress for five of the involved construction contracts valued at approximately \$930,000, and, therefore, funds associated with these contracts were still at risk due to the lack of payment and performance bonds. Further, any future contracts executed by the grantee that exceed the simplified acquisition threshold will be at risk if the grantee does not implement new procedures to correct this deficiency.

Compliance with 24 CFR 85.36(h) is required according to 24 CFR part 570 subpart J, compliance with which is required according to the NSP1 notice (Federal Register Volume 73, Number 194, dated October 6, 2008). 24 CFR 85.36(h) states that the awarding agency may accept the bonding policy and requirements of the grantee or subgrantee provided the awarding agency has made a determination that the awarding agency's interest is adequately protected. No exception was provided to the grantee, so this provision for alternate requirements was not applicable.

The Grantee Charged Ineligible Salary Costs

The grantee charged ineligible employee salary costs to the NSP1 grant for time spent working on other projects that were not related to the NSP1 grant. For the period July through September 2009, the grantee initially charged \$23,036 (including \$3,250 in “administrative” costs and \$19,787 in “project delivery” costs) to the NSP1 grant for hours claimed as having been worked by two of its employees. Then in March 2010, the grantee made an accounting adjustment to bill an additional \$22,344 in “administrative” labor costs to the grant for these employees for this same period. However, information obtained from grantee staff indicated that the involved employees worked on other projects during this period and did not work the additional hours on the NSP1 grant as claimed. Because the involved employees apparently did not work the additional hours claimed as part of the accounting adjustment, the added charge of \$22,344 was not an eligible program expense. This problem occurred because grantee officials did not follow program requirements including those specified in OMB Circular A-87, which states that direct costs for employee compensation must be for time devoted and identified specifically to the performance of the award and that personnel activity reports or equivalent documentation is required for employees that work on multiple activities or cost objectives.

The Grantee Did Not Properly Enforce Continued Affordability Requirements

The grantee placed excessive liens on NSP1-assisted properties when attempting to enforce the program’s continued affordability requirements. These requirements were enacted to ensure that assisted properties remained affordable for individuals or families that met specified income requirements. For properties that are rehabilitated and sold by the grantee, HUD regulations at 24 CFR 92.254(a)(5)(ii)(a)(5) define the amount that is subject to recapture by the grantee if a homeowner sells the NSP1-assisted property before the defined affordability period expires. It states that the amount subject to recapture “includes any HOME [HOME Investment Partnerships Program] assistance that reduced the purchase price from fair market value to an affordable price, but excludes the amount between the cost of producing the unit and the market value of the property (i.e. the development subsidy).”

The grantee did not comply with these standards because it included the “development subsidy” as part of the recapture amount specified in deed restrictions it used to enforce the continued affordability requirements. For example, one of the grantee’s single-family home purchasers paid the full appraised value of \$102,500 for a single-family house and received \$15,000 in downpayment assistance. In addition to a lien for the downpayment assistance amount, the grantee placed a lien on this property for the development subsidy,

which would be approximately \$48,200 (47 percent of the property value). Grantee staff members stated that they were not aware that the development subsidy should have been excluded from the calculated recapture amount. As a result of this deficiency, individuals that purchased NSP1-assisted properties at full market value could be subject to repayment on excessive liens if they sell the property. Since the borrowers paid full market price for the property and did not receive any benefit associated with the development subsidy, this practice is inappropriate.

Additionally, the recorded liens included a definition of the recapture amount, yet did not specify the actual amount subject to recapture. Accordingly, when the borrower attempts to transfer the property, this omission could create confusion regarding the actual amount needed to release the lien and could also potentially limit the enforceability of the lien.

Based upon cost and appraisal amounts provided by the grantee, the excessive liens for nine properties already resold by the grantee totaled approximately \$317,000. If the grantee continues this practice, excessive liens for the 14 properties that were completed and not yet resold will total at least \$532,920. If the grantee does not correct this deficiency, there will likely be additional excessive lien amounts for the remaining 14 home-ownership units under development and any additional units developed using NSP1 program income.

In another case, the grantee did not properly secure a deed restriction that was needed to enforce the NSP1's continued affordability requirements. The grantee provided \$141,610 in assistance to a homeowner to demolish and rebuild a house. The property rehabilitation was started in March of 2010, yet at the time of our audit, the grantee had not recorded a deed restriction to ensure that funds would be recaptured as required if the property was sold. During the audit, we notified the grantee of this problem and the grantee provided us its agreement with the homeowner documenting that the homeowner agreed to the resale restrictions in March of 2010. However, because a deed restriction was not recorded with the County Recorder's Office, the NSP1 funds remained at risk because there was no assurance that the funds would be recaptured if the property was sold or transferred. Further, the amounts specified in the resale restriction documents did not account for \$23,966 in additional NSP1 assistance used for construction change orders and grantee labor costs for this property.

Conclusion

The grantee did not comply with HUD's program requirements, and as a result, a portion of the grantee's NSP1 grant funds was at risk, and HUD did not have assurance that NSP1 funds were used for eligible costs. Also, individuals that purchased rehabilitated homes from the grantee could be subjected to excessive liens. These problems occurred because the grantee's staff was not familiar with the applicable program requirements and the grantee did not implement appropriate procedures to ensure that these requirements were met.

Recommendations

We recommend that the Acting Director, San Francisco Office of Community Planning and Development, require the grantee to

- 1A. Implement adequate controls over construction contractor draw requests including procedures to require an updated and detailed schedule of values at the time of each draw. Contractors should be required to certify as to the accuracy of the draw amount and work claimed as having been completed.
- 1B. Implement procedures to ensure the eligibility of labor costs claimed by its subrecipient.
- 1C. Reimburse its NSP1 grant for any ineligible subrecipient labor costs that were paid using NSP1 funds. To determine the eligibility of the unsupported costs, HUD should require the grantee to provide detailed documentation regarding the costs including subgrantee payroll records (such as pay stubs to determine hourly rates and time cards to determine the number of hours worked). These records should be compared to the amounts billed to the NSP1 grant to determine the amount of the unsupported costs that was an not eligible program expense.
- 1D. Implement procedures to require construction contractors to obtain payment and performance bonds for contracts that exceed the simplified acquisition threshold and reimburse the NSP1 grant using non-Federal funds for any costs that result from the grantee's failure to obtain payment and performance bonds. The recommended actions will address the risk of losses from the unexpended balance of \$186,597 associated with existing contracts.
- 1E. Reimburse the NSP1 grant \$22,344 from non-Federal funds for the ineligible grantee labor costs that were charged to the NSP1 grant.
- 1F. Implement procedures to ensure that excessive liens are not placed on NSP1-assisted properties.
- 1G. Remove the excessive liens that were recorded against its NSP1-assisted properties that have already been sold and record appropriate deed restrictions on these properties in accordance with HUD program requirements.
- 1H. Take action to ensure the enforceability of the NSP1's continued affordability requirements for the one property that was assisted with \$141,610 in NSP1 funds and did not have recorded deed restrictions.

SCOPE AND METHODOLOGY

We performed our audit from August to December 2010 at the grantee's offices at 20 East Main Street, Mesa, AZ. The audit covered the period March 2009 to September 2010.

To achieve our objectives, we

- Reviewed HUD handbooks, the Code of Federal Regulations, Federal Registers, OMB circulars, and other requirements and directives that govern NSP1.
- Reviewed HUD's recent monitoring report for the grantee's HOME program.
- Reviewed grantee accounting records, policies and procedures, and project files.
- Reviewed the grantee's NSP1 agreement with HUD.
- Reviewed the grantee's subrecipient agreement with Housing Our Communities.
- Reviewed a nonstatistical sample of four grantee files for properties purchased, rehabilitated, and resold by the grantee using NSP1 funds. For these transactions, we evaluated whether the property was eligible for program assistance; the applicant was eligible for program assistance; contracting procedures were performed as required; and the activity's expenses were eligible and adequately documented and complied with NSP1 requirements.
- Interviewed grantee staff and HUD Office of Community Planning and Development program staff.
- Conducted site visits to three rehabilitation properties to confirm their existence and evaluate the completeness of the rehabilitation.
- Researched the Lexis-Nexis database and Arizona Corporation Commission Web site for possible affiliations and conflicts of interest.
- Researched the Lexis-Nexis database and Maricopa County Recorder's Web site for recorded deeds and mortgages on NSP-assisted properties.
- Examined payment invoices submitted by Housing Our Communities for counseling and acquisition services. We examined all of the payment invoices, totaling more than \$37,000, that were billed for the period March 19 through September 1, 2010.
- Evaluated whether the subgrantee's labor costs charged complied with OMB requirements.

We were unable to determine the amount of the subgrantee's ineligible labor costs because detailed documentation regarding the grantee's actual cost was not available for us to review and validate at the time of the audit.

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:

- Policies and procedures to ensure that program activities comply with applicable laws and regulations.
- Policies and procedures to provide reasonable assurance that funds are used only for authorized purposes.

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 Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- The grantee did not have controls in place to ensure compliance with HUD program requirements related to construction contractor draw requests, cost eligibility, construction contractor bonding, and continued affordability restrictions (see finding 1).

APPENDIXES

Appendix A

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

Recommendation number	Ineligible 1/	Funds to be put to better use 2/
1D		\$186,597
1E	\$22,344	
1H		\$141,610

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/ Recommendations that funds be put to better use are estimates of amounts that could be used more efficiently if an Office of Inspector General (OIG) recommendation is implemented. These amounts include reductions in outlays, deobligation of funds, withdrawal of interest, costs not incurred by implementing recommended improvements, avoidance of unnecessary expenditures noted in preaward reviews, and any other savings that are specifically identified.

The funds to be put to better use for recommendation 1D represent the amount of funds not yet expended on incomplete projects with contracts that exceeded the simplified acquisition threshold and did not have required payment and performance bonds. These funds remain at risk because the grantee did not implement procedures to require contractors to obtain payment and performance bonds. Note that the funds associated with existing contracts for incomplete projects would also be at risk due to the grantee's insufficient controls over construction contractor draw requests (recommendation 1A); however, we did not include an amount in the table above for this recommendation to avoid duplicate reporting of the amounts potentially at risk. The funds to be put to better use for recommendation 1H represent the amount of NSP1 funds used for the one property that did not have recorded deed restrictions necessary to enforce the program's continued affordability requirements.

Appendix B

AUDITEE COMMENTS

Auditee Comments



20 E Main St Suite 750
PO Box 1466
Mesa, Arizona 85211-1466

January 3, 2011

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

Dear Ms. Schulze:

Enclosed is the City of Mesa's response to the draft audit report your office recently completed on our Neighborhood Stabilization Program (NSP1) Grant. We appreciate the opportunity to respond to the report before it is finalized.

Let me assure you that the City of Mesa is fully committed to strengthening our processes and procedures in order to come into full compliance with program regulations. As we discussed with you at our exit conference, we are exploring the possibility of bringing in an outside expert to conduct an in-depth review and assessment of our policies, procedures and practices and a risk analysis based on current City operations. And, as always, we will continue to work closely with our local HUD representatives to ensure that our processes and systems provide the necessary safeguards as well as the proper checks and balances.

The NSP program continues to be a major element in the City's efforts to revitalize our neighborhoods, reduce blight, and bolster neighborhood home values in these tough economic times. We believe our program has been extremely successful as indicated by the \$26,000 sales price increase in single family homes for the zip code we targeted for the program. We look forward to continuing this success with NSP3.

If you have any questions regarding our response, please do not hesitate to contact me.

Sincerely,

A handwritten signature in blue ink that reads 'Trisha Sorensen'.

Trisha Sorensen
Acting Deputy City Manager
Attachments

480.644.3333 (tel)
480.644.2175 (fax)

AUDITEE COMMENTS AND OIG's EVALUATION

Ref to OIG Evaluation

Auditee Comments

1A. Implement adequate controls over construction contractor draw requests including procedures to require an updated and detailed schedule of values at the time of each draw. Contractors should be required to certify as to the accuracy of the draw amount and work claimed as having been completed.

The City is modifying the procedure specified in its 2010-2011 Administrative Annual Plan to ensure that contractor draws are processed as they are requested by the contractor and that the amount approved is calculated on actual work completed. The basis for calculating work completed will be contractor's line item project scope of work. Contractors will be required to verify the draw requests and the City's assessment of each request by signing and dating each request approved by the City. This revised procedure will be submitted to HUD as part of its audit resolution work plan.

The revised policy will also be included in the City's 2011/2012 Administrative/Annual Plan.

Staff will receive training on the new procedures.

Ref to OIG Evaluation

Auditee Comments

1B. Implement procedures to ensure the eligibility of labor costs claimed by its subrecipients.

The City has developed a draft policy (Neighborhood Services Subrecipient Direct and Indirect Cost Calculation) that describes how the City will determine allowable subrecipient costs. This policy will be submitted to HUD as part of its audit resolution work plan.

When determining direct costs, subrecipients will be required to provide a detailed hourly cost analysis for each employee providing services under the program. Supporting documentation will be required and will include payroll stubs, time cards, or other documentation of the hourly charges. In addition, subrecipients will be required to establish allowable indirect cost rates as described in OMB Circular A-122.

The City also proposes to establish indirect costs rates with subrecipients at the time that subrecipient agreements are negotiated.

Staff will receive training on the policy.

Ref to OIG Evaluation

Auditee Comments

1C. Reimburse its NSP1 grant for any ineligible subrecipient labor costs that were paid using NSP1 funds. To determine the eligibility of the unsupported costs, HUD should require the grantee to provide detailed documentation regarding the costs including subgrantee payroll records (such as payroll stubs to determine hourly rates and time cards to determine the number of hours worked). These records should be compared to the amounts billed to the NSP1 grant to determine the amount of unsupported cost that was not an eligible program expense.

The City will work with its NSP subgrantee to verify all costs claimed by the subgrantee and reimbursed by the City under NSP1. The City will require the subgrantee to provide appropriate documentation (such as payroll stubs and time cards) to verify direct costs. The City will work with the subgrantee to develop an appropriate indirect cost rate in compliance with OMB Circular A-122.

Ref to OIG Evaluation

Auditee Comments

1D. Implement procedures to require construction contractors to obtain payment and performance bonds for contracts that exceed the simplified acquisition threshold and reimburse the NSP1 grant using non-federal dollars for any costs that result from the grantee's failure to obtain payment and performance bonds. The recommended actions will address the risk of losses from the unexpended balance of \$186,597 associated with existing contracts.

Beginning immediately the City will request the required contract performance and payment bonds from contractors working on current projects under the NSP1 grant. All future contracts under NSP1 that exceed the simplified acquisition threshold will be required to include contractor performance and payment bonds from the contractors providing services to those projects.

Ref to OIG Evaluation

Auditee Comments

1E. Reimburse the NSP1 grant \$22,344 from non-Federal funds for the ineligible grantee labor costs that were charged to the NSP1 grant.

The City will reimburse the NSP1 grant using non-Federal funds in the amount of \$22,344. This will be accomplished by the end of February 2011.

Ref to OIG Evaluation

Auditee Comments

1F. Implement procedures to ensure that excessive liens are not placed on NSP1-assisted properties.

The City Attorney has been advised of the lien requirements as specified in the HUD regulations (24 CFR 92.2549(a)(5)(ii)(a)(5)). Liens on all future properties assisted under NSP1 will conform to these requirements.

Ref to OIG Evaluation

Auditee Comments

1G. Remove the excessive liens that were recorded against its NSP1-assisted properties that have already been sold and record appropriate deed restrictions on those properties in accordance with HUD program requirements.

The City is working through its City Attorney's Office to correct the existing excessive liens in place on 11 of the homes that that have been sold under NSP1 and amendments will be made to the liens to correct the excessive liens. Notification letters have been drafted to the lenders advising them of the amendment. The City does not anticipate encountering any resistance to the amendments since they are less restrictive than the previous liens.

Ref to OIG Evaluation

Auditee Comments

1H. Take action to ensure that the enforceability of the NSP1's continued affordability requirements for the one property that was assisted with \$141,610 in NSP1 funds and did not have recorded deed restrictions.

The required liens were submitted to the Maricopa County Recorder's Office on January 12, 2011 and the deeds have been secured. The City has also secured an additional lien in the amount \$22,966.00 for change orders that occurred during the rehabilitation of the property.