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TO: Frances M. Cleary, Director, Kansas City Office of Public Housing, 7APH

FROM: Ronald Hosking, Regional Inspector General for Audit, 7AGA

SUBJECT: The Manhattan, KS, Housing Authority Improperly Executed a Contract Change Order and Did Not Accurately Report on Its Recovery Act Funds

## **HIGHLIGHTS**

### **What We Audited and Why**

We reviewed the Manhattan, KS, Public Housing Authority. We selected the Authority for review because it received funding under the American Recovery and Reinvestment Act of 2009. Our audit objectives were to determine whether the Authority executed a contract change order in compliance with U.S. Department of Housing and Urban Development (HUD) procurement regulations and the Authority's procurement policy and accurately and completely reported Recovery Act grant information in FederalReporting.gov.

### **What We Found**

The Authority improperly executed a contract change order. In addition, it did not accurately or completely report Recovery Act grant information in FederalReporting.gov.

## **What We Recommend**

We recommend that the Director of HUD's Kansas City Office of Public Housing work with the Authority to develop and implement written policies and procedures for executing a contract change order. We also recommend that the Director work with the Authority to support the \$10,349 in contractor and subcontractor fees. For any portion of the fees that is not supported, HUD should reduce future annual capital funds. Lastly, we recommend that the Director work with the Authority to update its Recovery Act Web site as appropriate to reflect the correct program information.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

## **Auditee's Response**

We provided the draft report to the Authority on March 26, 2012 and requested a response by April 9, 2012. The Authority provided written comments on March 30, 2012. The Authority agreed with our findings and recommendations.

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

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## **BACKGROUND AND OBJECTIVES**

The City of Manhattan, KS, created the Manhattan Housing Authority in November 1969. The Authority's mission is to assist income-qualified persons with decent, safe, and affordable housing in an efficient, ethical, and professional manner. A seven-member board of commissioners governs the Authority, and an executive director manages its daily operations. The members of the board are appointed by the mayor and city commission of Manhattan. The Authority's central office is located at 300 North 5th Street, Manhattan, KS.

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009. This legislation included a \$4 billion appropriation of capital funds to carry out capital and management activities for public housing agencies as authorized under Section 9 of the United States Housing Act of 1937. The Recovery Act requires that \$3 billion of these funds be distributed as formula grants and the remaining \$1 billion be distributed through a competitive grant process. On March 18, 2009, the U.S. Department of Housing and Urban Development (HUD) awarded the Authority a \$468,163 Recovery Act formula grant.

The Recovery Act imposed reporting requirements and stringent obligation and expenditure requirements for grant recipients beyond those applicable to ongoing Public Housing Capital Fund program grants. For example, the Authority was required to obligate 100 percent of its Recovery Act formula grant funds by March 18, 2010, and expend 100 percent of these funds by March 18, 2012. As of December 31, 2010, the Authority had obligated and expended all of its Recovery Act grant funds. Transparency and accountability are critical priorities in the funding and implementation of the Recovery Act.

Our audit objectives were to determine whether the Authority executed a contract change order in compliance with HUD procurement regulations and the Authority's procurement policy and accurately and completely reported Recovery Act grant information in FederalReporting.gov.

## RESULTS OF AUDIT

### Finding 1: The Authority Improperly Executed a Contract Change Order

The Authority improperly executed a contract change order. This condition occurred because the Authority did not have written policies and procedures for executing a contract change order. As a result, HUD lacked assurance that the Authority received the best value for more than \$53,000 spent on the change order.

#### **Improperly Executed a Contract Change Order**

The Authority executed a contract change order outside the scope of the original contract without requiring contractors to provide the required cost breakdown of the proposals or completing the independent cost estimate before reviewing proposals.

The Authority executed a contract change order that was outside the scope of the original contract. It originally entered into a contract to replace 47 heating, ventilation, and air conditioning (HVAC) and hot water heater units in March of 2010. The change order was executed to wrap existing duct work with insulation to eliminate condensation damage to the ceiling and light fixtures. The original contract required only the new HVAC units to be attached to the existing duct work and did not require replacement or improvement of duct work.

HUD Handbook 2210.18, paragraph 1.2(B)(4), states that modifications that change the scope of work beyond the original contract must be justified as noncompetitive or procured competitively. The Authority did not justify the change order services as noncompetitive or procure the services competitively.

The Authority did not require contractors to provide the required cost breakdown of the proposals submitted for the change order services. HUD Handbook 2210.18, paragraph 1.2(B)(4), states that the Authority must request a cost breakdown of the proposed cost. Further, form HUD-5370 states that contractors must break down proposals into direct costs, indirect costs, and profit.

The Authority could not support the more than \$10,000 in contractor and subcontractor fees charged for administering the change order services. Form HUD-5370 states that contractors are prohibited from receiving profit on the profit received by subcontractors. The primary service provider submitted a proposal of \$42,490 to the subcontractor. The subcontractor then increased the proposal by \$5,546 for overhead and submitted it to the general contractor. The general

contractor increased the proposal by \$4,803 before submitting the final proposal to the Authority.

The Authority reviewed the contractor and subcontractor proposals and supplied them to the engineer before the engineer completed the required independent cost estimate. Regulations at 24 CFR (Code of Federal Regulations) 85.36(f)(1) state that at a starting point, grantees must make independent cost estimates before receiving bids or proposals. The general contractor of the original contract submitted a bid for the change order to the Authority on March 10, 2010, in the amount of \$53,220. On March 12, 2010, the Authority's engineer sent an email to the Authority indicating that he had reviewed the bid proposal and estimated the work cost to be between \$47,000 and \$70,500. The Authority used the engineer's estimate as the independent cost estimate for the change order.

### **The Authority Lacked Written Policies and Procedures**

The Authority did not have written policies and procedures for executing a contract change order. It adopted a sample HUD procurement policy and did not expand the policy to incorporate the requirements for executing change orders included in HUD Handbook 7460.8, REV-2, section 11.4, and HUD Handbook 2210.18, section 1.2.

### **HUD Lacked Assurance That The Authority Received the Best Value**

As a result of the conditions described above, HUD lacked assurance that the Authority received the best value for more than \$53,000 spent on a contract change order. The contractor that provided the change order services was a sole source provider in the Authority's location. The Authority might have avoided more than \$10,000 in contractor and subcontractor fees had it properly procured the duct wrap insulation instead of improperly executing a contract change order.

### **Recommendations**

We recommend that the Director of HUD's Kansas City Office of Public Housing work with the Authority to

- 1A. Develop and implement written policies and procedures for executing a contract change order.

- 1B. Support the \$10,349 in contractor and subcontractor fees. For any portion of the fees that is not supported, HUD should reduce future annual capital funds.

## Finding 2: The Authority Did Not Accurately or Completely Report Recovery Act Grant Information in FederalReporting.gov

The Authority did not accurately or completely report Recovery Act grant information in FederalReporting.gov. This condition occurred because Authority staff did not receive adequate training. As a result, the public did not have access to accurate and complete grant information.

### **The Authority Did Not Accurately or Completely Report Required Information**

The Authority generally obligated and expended Recovery Act grant funds in accordance with Recovery Act requirements, but it did not accurately or completely report its Recovery Act grant information in FederalReporting.gov. According to the Recovery Act requirements (2 CFR Part 176) and Office of Management and Budget (OMB) guidance, Recovery Act grant recipients are required to report the following information in FederalReporting.gov:

- Amount of the Recovery Act grant award,
- Project information for use of the grant funds,
- Number of jobs created or retained with the Recovery Act grant,
- Funds invoiced,
- Funds received,
- Expenditure amounts,
- Listing of vendors receiving Recovery Act funds, and
- Vendor transactions.

The Authority did not accurately or completely report the vendors that received payments greater than \$25,000 in FederalReporting.gov. The OMB memorandum M-09-21, section 2.3, requires Recovery Act grant recipients to report additional data elements for vendors who received payments greater than \$25,000. The Authority had seven instances of individual payments greater than \$25,000 made to four vendors during the second and third quarters of 2010. The Authority did not report any of the required vendor information for the vendors that received payments greater than \$25,000.

Also, the Authority did not accurately or completely report in FederalReporting.gov the number of jobs created or retained using Recovery Act grant funds for the first three quarters of 2010. The following chart shows the difference between the number of jobs reported by the Authority and the number that should have been reported.

Quarter	Start date	End date	Jobs created or retained reported in FederalReporting.gov	Actual jobs created or retained	Reporting difference
1	1/1/2010	3/31/2010	0	0.4	(0.40)
2	4/1/2010	6/30/2010	7.31	8.7	(1.39)
3	7/1/2010	9/30/2010	7.5	0.25	7.25
4	10/1/2010	12/31/2010	0	0	0

( ) represents jobs underreported.

### The Authority Did Not Receive Adequate Training

The Authority's staff did not receive adequate training. According to the assistant executive director, Authority staff responsible for entering the data into FederalReporting.gov did not receive training.

### The Public Did Not Have Access to Accurate Grant Information

As a result of the conditions described above, the public did not have access to accurate and complete grant information.

### Recommendations

Since the Authority had completed its Recovery Act reporting requirements, we did not provide recommendations related to the cause of this finding. However, we recommend that the Director, Office of Public Housing, work with the Authority to

- 2A. Update its Recovery Act Web site as appropriate to reflect the correct program information.

## SCOPE AND METHODOLOGY

Our review generally covered the period January 2009 through September 2010. We conducted our fieldwork from November 2011 through January 2012 at the property located at 300 North 5<sup>th</sup> Street, Manhattan, KS.

To accomplish our objectives, we

- Interviewed the Authority's staff and its contractors, subcontractors, and architects.
- Interviewed HUD's Office of Public and Indian Housing staff in Kansas City, KS.
- Obtained a review of architects' drawings and scope of work by a HUD Office of Inspector General (OIG) appraiser.
- Reviewed the Authority's Recovery Act procurement policies, procurement and contracting files, and financial records.
- Reviewed Federal regulations, the Recovery Act, and HUD requirements.

We reviewed 100 percent of the Authority's Recovery Act grant obligations and expenditures. The entire grant was obligated with five contracts, a contract change order, and advertising costs. As of September 2010, the Authority had expended the entire Recovery Act grant.

We did not rely on computer-processed data or select samples for our audit purposes. We traced or verified information from HUD's Line of Credit Control System and data that the Authority self-reported in FederalReporting.gov to supporting documentation to support our audit conclusions.

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

# INTERNAL CONTROLS

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

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

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

## Relevant Internal Controls

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

- Controls over the obligation of Recovery Act funds.
- Controls over the procurement and use of Recovery Act funds.
- Controls over the reporting of Recovery Act grant information in [FederalReporting.gov](http://FederalReporting.gov).

We assessed the relevant controls identified above.

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

## Significant Deficiencies

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

- The Authority lacked written policies and procedures for executing contract change orders (finding 1).

- The Authority did not provide training to staff responsible for entering data into FederalReporting.gov (finding 2).

## APPENDIXES

### Appendix A

#### SCHEDULE OF QUESTIONED COSTS

Recommendation number	Unsupported 1/
1B.	\$10,349

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- 1/ Unsupported costs are those costs charged to a HUD-financed or HUD-insured program or activity when we cannot determine eligibility at the time of the audit. Unsupported costs require a decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of departmental policies and procedures.

## Appendix B

### AUDITEE COMMENTS

**March 30, 2012**  
**Response to OIG Report on ARRA Funds**

**FINDING NO. 1**

The Authority executed a contract change order outside the scope of the original contract without requiring contractors to provide the required cost breakdown of the proposals or completing the independent cost estimate before reviewing proposals.

**RESPONSE TO FINDING NO. 1**

The Manhattan Housing Authority regrets the error, and agrees that revisions should be made to the existing Procurement Policy that will provide additional procedural information for procuring and executing contract change orders. It should be noted that at the time the ARRA Capital Funds were awarded, MHA was designated Financial Troubled; therefore, in accordance with federal regulations, all procurement and contract documents required review and approval by the HUD Field Office. The Change Order was reviewed and approved by the HUD Field Office prior to its execution, therefore does not agree that \$10,349 should be withheld from future Capital Fund Program funding. MHA will work with the HUD Field Office to resolve the matter.

**FINDING NO. 2**

The Authority did not accurately or completely report the vendors that received payments greater than \$25,000 in FederalReporting.gov. Also, the Authority did not accurately or completely report in FederalReporting.gov the number of jobs created or retained using Recovery Act grant funds for the first three quarters of 2010.

**RESPONSE TO FINDING NO. 2**

The Manhattan Housing Authority (MHA) regrets the error. Due to vague guidance that was subject to interpretation, the information was incorrectly reported with no intention of untruthfulness. MHA will work with the HUD Field Office to update data in FederalReporting.gov to reflect accurate data.