AUDIT REPORT

PROCUREMENT OF MANAGEMENT AGENTS

PUERTO RICO PUBLIC HOUSING ADMINISTRATION

SAN JUAN, PUERTO RICO

2003-AT-1002

MARCH 21, 2003

OFFICE OF AUDIT, REGION IV

Issue Date	March 21, 2003
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TO: Olga Saez, Acting Director, Office of Public Housing, Caribbean Office, 4NPH

FROM: Nancy H. Cooper
Regional Inspector General for Audit, 4AGA

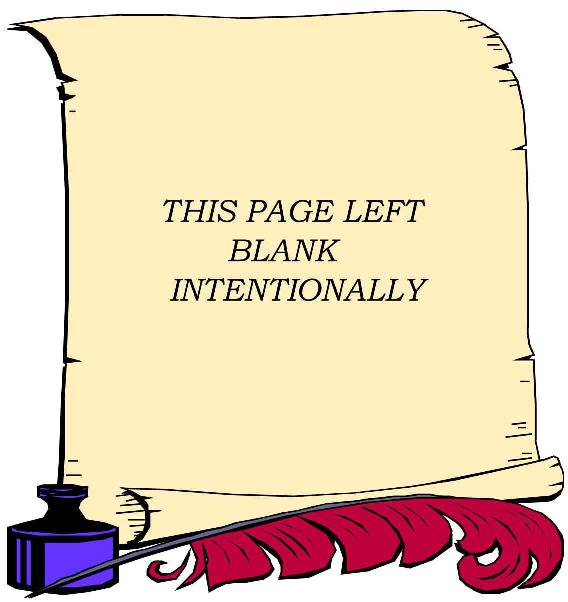
N. H. Cooper

SUBJECT: Procurement of Management Agents
Puerto Rico Public Housing Administration
San Juan, Puerto Rico

We completed a review of the Puerto Rico Public Housing Administration's (PRPHA) management agent contracts. The review was initiated in response to the indictment of a former management agent official for excessive charges to the public housing program. Our objectives were to determine whether the management agent contracts awarded during 1999 were procured in a manner providing full and open competition consistent with the standards and awarded on terms and prices beneficial to the PRPHA. Our report includes four findings.

In accordance with the Department of Housing and Urban Development (HUD) Handbook 2000.06 REV-3, within 60 days, please provide us, for each recommendation without management decisions, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Additional status reports are required at 90 days and 120 days after report issuance for any recommendation without a management decision. Also, please furnish us copies of any correspondence or directives issued related to the audit.

Should you or your staff have any questions, please contact me or Sonya D. Lucas, Assistant Regional Inspector General for Audit, at (404) 331-3369.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Executive Summary

We completed a review of the Puerto Rico Public Housing Administration's management agent contracts. We began the review in response to the indictment of the general manager of one of the management agents involving excess charges to the public housing program. Our objectives were to determine whether the management agent contracts awarded during 1999 were procured in a manner providing full and open competition consistent with the standards and awarded on terms and prices beneficial to the PRPHA.

Our assessment showed that the former PRPHA Administrator failed to ensure that the contracts awarded were procured in a manner providing full and open competition consistent with the standards, and were reasonable and beneficial to the PRPHA. The PRPHA: (1) disregarded procurement requirements; (2) executed financially burdensome management contracts; (3) paid excessive non-project salaries; and (4) paid excessive overhead and profit. We estimate these 5-year contracts to have been awarded at $35 million more than was necessary.

Our review disclosed

The PRPHA did not comply with Federal procurement requirements for the 1999 procurement of its public housing management agents. It did not properly document the use of valid and supported cost estimates, improperly released confidential information, used an inefficient ranking criteria, did not adequately support the performance of independent price or cost analyses for the proposals, and failed to maintain adequate procurement records. The PRPHA's former management disregarded Federal procurement requirements and failed to implement or ignored controls to plan, solicit, and award contracts. Irresponsibility by those officials of the PRPHA has proven to be financially detrimental to the PRPHA and unduly enriching to the private firms. The PRPHA's operating reserves for the low-rent program declined from $108 million in fiscal year 1999 to $25 million in fiscal year 2001, primarily because of the significant increase in the management fees paid to the management agents. The failed procurement resulted in financially burdensome management contracts, which allowed excessive non-project salaries, overhead, and profit as discussed in further detail in Findings 2, 3, and 4.

As discussed in Finding 1, the PRPHA's management controls failed to ensure that contracts awarded to management agents in April 1999 were in the best interests of the PRPHA, its residents, or the taxpayer. The PRPHA executed unreasonable, erroneous, and burdensome contracts with management agents that adversely impacted the PRPHA's financial solvency. The PRPHA contracted for management of its public housing units at rates higher than previous years' contracts and higher than what other authorities paid by allowing their management agents to include excessive salaries, overhead, and profit. We attribute this to the former PRPHA Administrator's disregard of duties. As of September 30, 2002, the PRPHA possibly overpaid for management services by approximately $24.5 million and could incur additional excess costs of over $10.8 million if corrective actions are not taken.

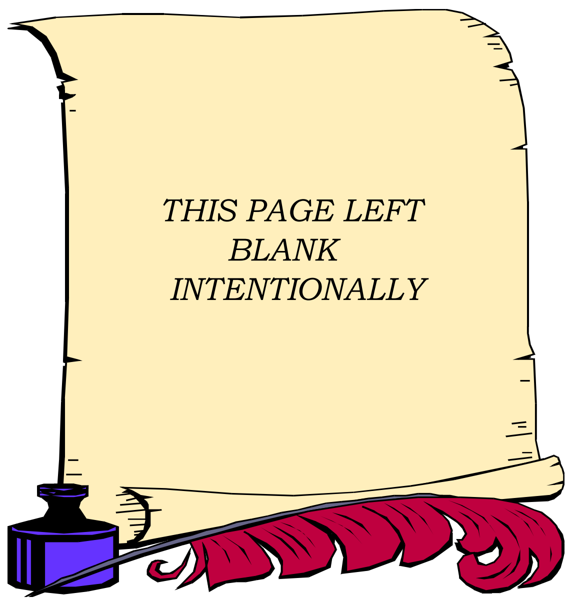
Non-project salaries and benefits was one of the three management fee components paid by the PRPHA. The charges were based on payroll expenditures incurred by non-project personnel. The non-project salaries paid to GAR Housing, Westbrook Management, and Housing Promoters during fiscal year 2000-2001 totaled $2,886,324. We reviewed the non-project salaries charged by the three management agents and identified that the management agents charged over $423,646 for items that were excessive, were not allocable to the public housing program, or violated the management contract. We attribute the above deficiencies to the PRPHA's failure to conduct price/cost analyses of the cost proposals. As a result, an unnecessary burden was placed on the PRPHA and the taxpayers.

Overhead and profit were the remaining two management fee components paid by the PRPHA. The overhead charges were billed as a fixed monthly or semi-monthly amount based on the approved budget, regardless of the actual overhead expenditure incurred during the billing period. The overhead allowance paid by the PRPHA during fiscal year 2000-2001 to GAR Housing, Housing Promoters, and Westbrook Management totaled $2,152,657. We identified that the management agents incurred overhead expenditures of over $1,047,633 that were excessive, were not allowable and/or allocable to the public housing program, or violated the management contract. The expenditures included payments to identity-of-interest firms, purchase of gifts and flower arrangements, social gathering, and donations. The management agents' profit contracted for the 5-year period was $36,294,643 and this also was excessive. The management agents did not have uniformity or consistency for the contracted profits. Although each management agent had about the same number of units, the profit approved or charged was not within the same ranges. We projected that the excessive profit would exceed $25 million for the 5-year contract period. We attribute the deficiencies to the PRPHA's failure to conduct price/cost analyses of cost the proposals.

Recommendations

We recommend that you work with the PRPHA to remedy the deficiencies in the contract, or require the PRPHA to pursue all available options provided by the agents' service contracts to ensure the best interests of the PRPHA and HUD are being served, and possibly save $10.8 million in costs not incurred. We also recommend that you require the PRPHA to deduct $2,007,019 from GAR's invoices to correct the costs improperly included in the proposal and contract award. In addition, we recommend that you consider appropriate administrative action against the former PRPHA Administrator and others for gross mismanagement of the procurement process.

We presented our results to the PRPHA and HUD officials during the audit. We provided a copy of the draft report to the PRPHA and HUD's Caribbean Office on February 5, 2003, for their comments. We discussed the report with the officials at the exit conference on February 11, 2003. The PRPHA provided written comments on February 28, 2003. The PRPHA's comments are summarized in the findings and included in their entirety as Appendix E.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Abbreviations

HUD	U.S. Department of Housing and Urban Development
PRPHA	Puerto Rico Public Housing Administration
PUM	Per Unit Per Month

Introduction

Puerto Rico's public housing and urban renewal programs started in 1938. By 1957 the Puerto Rico Urban Renewal and Housing Corporation, the PRPHA's predecessor, was created by Commonwealth Law No. 88 for the purpose of reorganizing the programs. In 1972, the government of Puerto Rico established the Department of Housing (Law 97 dated June 10, 1972). Under this law, the Puerto Rico Urban Renewal and Housing Corporation was attached to the Department of Housing, and the powers and faculties of the Board of Directors were transferred to the Secretary of Housing.

The PRPHA was created in 1989 and placed under the direction of the Puerto Rico Department of Housing for the purpose of creating an efficient and flexible administration of public housing (Law 66 dated August 17, 1989). In 1991, the Puerto Rican Government dissolved the Puerto Rico Urban Renewal and Housing Corporation and transferred the powers and faculties of its Public Housing Program to the Puerto Rico Secretary of Housing. The PRPHA is the second largest public housing authority in the nation with over 55,000 dwelling units scattered throughout Puerto Rico.

In 1992, the PRPHA contracted all of its housing projects management functions to private management agents. The contracts were cancelled in 1995 and another bid process was performed. For the new bid process, the PRPHA divided its public housing projects into 21 regional areas. The administration of those areas was awarded to 18 private management agents. The contracts were effective until April 30, 1999.

In November 1998, the PRPHA started another procurement process for the administration of its public housing projects. It published a request for proposal for management services to administer over 55,000 of its public housing units to be divided into 15 geographical regions. A total of 30 firms submitted proposals, and on April 21, 1999, the PRPHA awarded 5-year contracts to the following 15 private management companies.

Region	Management Agent	Units
I	Nereida Falto de Cole, Inc. (NFC)	3,559
II	SP Management Corp.	3,866
III	American Management Corp.	3,599
IV	Housing Promoters Corp.	3,531
V	Martinal Properties Corp.	3,602
VI	A & M Contractors, Inc.	3,870
VII	GAR Housing Corp.	3,539
VIII	Cost Control Company	3,523
IX	Peregrine Management Company	3,832
X	Miramar Property Management & Administration	3,611
XI	ERCO Enterprises, Inc.	3,722
XII	MJ Consulting & Development, Inc.	4,017
XIII	JA Machuca & Associates, Inc.	3,836
XIV	Westbrook Management	3,814
XV	Zeta Enterprises, Inc.	3,984

The proposals for the management agent services were to be evaluated and ranked based on the following seven components for a maximum of 100 points:

1) Staffing (15 points)
2) Knowledge of HUD regulations (15 points)
3) Property management experience (20 points)
4) Financial capability (15 points)
5) Resident Programs (15 points)
6) Security Programs (10 points)
7) Management fee (10 points)

In addition, the management agents were requested to submit their cost proposals for 5-years with quotes in the following four categories: (1) non-project salaries and benefits for central office personnel; (2) overhead; (3) profit; and (4) project salaries and benefits.

			Management Fee-Five Year Period						Management Cost	
Managing Firm	Area	Units	Non-Project Salaries	Overhead	Profit	Total	Per Unit Fee	Project Salaries	Total	Per Unit Cost
Nereida Falto de Cole Inc. (NFC)	I	3,559	$ 2,757,313	$ 1,862,083	$ 5,468,400	$ 10,087,796	$ 47	$ 14,588,109	$ 24,675,905	$116
SP Management Corp.	II	3,866	3,705,372	3,367,447	1,722,975	8,795,794	38	22,111,953	30,907,747	133
American Management	III	3,599	5,062,051	2,745,983	3,397,290	11,205,324	52	17,095,345	28,300,669	131
Housing Promoters, Inc.	IV	3,531	5,671,312	2,781,288	2,171,732	10,624,332	50	16,900,863	27,525,195	130
Martinal Properties Corp.	V	3,602	3,906,666	2,171,117	2,222,936	8,300,719	38	17,778,914	26,079,633	121
A.M. Contractors	VI	3,870	3,673,395	1,802,382	4,496,940	9,972,717	43	18,400,698	28,373,415	122
GAR Housing Corporation	VII	3,539	4,977,917	5,382,428	2,072,069	12,432,414	59	18,860,533	31,292,947	147
Cost Control Company	VIII	3,523	4,116,410	2,156,133	1,985,000	8,257,543	39	14,060,783	22,318,326	106
Peregrine Management	IX	3,832	4,301,445	2,039,179	2,141,712	8,482,336	37	18,008,034	26,490,370	115
Miramar Property Management	X	3,611	2,938,438	4,908,000	2,170,000	10,016,438	46	15,229,760	25,246,198	117
ERCO Enterprises, Inc.	XI	3,722	7,448,272	961,999	933,161	9,343,432	42	19,991,361	29,334,793	131
M.J. Consulting & Development	XII	4,017	3,908,443	3,098,415	2,651,254	9,658,112	40	23,596,528	33,254,640	138
J.A. Machuca & Associates	XIII	3,836	3,217,760	1,642,741	2,811,499	7,672,000	33	22,956,698	30,628,698	133
Westbrook Management Co.	XIV	3,814	4,927,650	3,320,082	995,040	9,242,772	40	20,185,597	29,428,369	129
Zeta Enterprises, Inc.	XV	3,984	3,799,267	3,231,631	1,054,635	8,085,533	34	26,360,069	34,445,602	144
Total		55,905	$64,411,711	$41,470,908	$36,294,643	$142,177,262	$ 42	$ 286,125,245	$428,302,507	$128

As shown in the above schedule, the management agents contracted per unit per month (PUM) management fees were between $33 and $59 and the per unit management costs were between $106 and $147.

In fiscal year 2001, the PRPHA received $270 million of Federal funding, including $175 million for its Capital Fund Program, $81 million of operating subsidy, and $14 million of Drug Elimination Program funds. For fiscal year 2002, the PRPHA was expected to receive $167 million for its Capital Fund Program and $93 million of operating subsidy. Congress did not appropriate funds for the Drug Elimination Program for fiscal year 2002.

Audit Objectives, Scope and Methodology

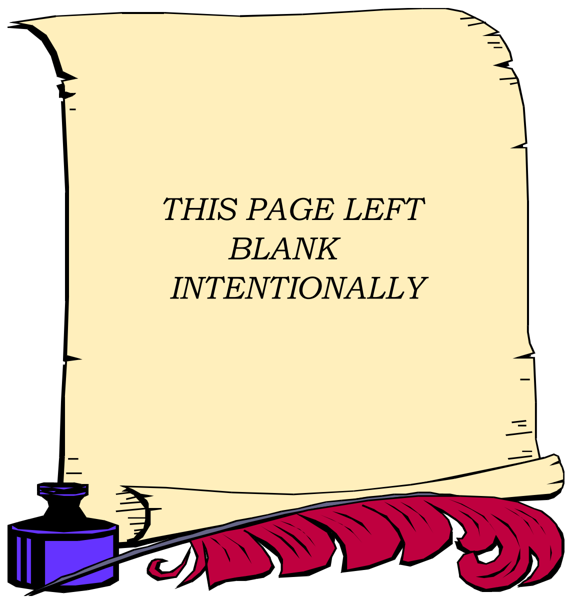
Our objectives were to determine whether the management agent contracts awarded during 1999 were procured in a manner providing full and open competition consistent with the standards and awarded on terms and prices beneficial to the PRPHA. To accomplish the objectives, we reviewed applicable laws, regulations, and other program related requirements and tested for compliance. We evaluated the PRPHA's procurement process in awarding the management agent contracts. We reviewed related PRPHA's and management agents' files and records for fiscal year 2001. We also interviewed responsible Caribbean Office Public Housing program officials, PRPHA staff, and management agent officials.

We contacted other housing authorities that operate through management agents to compare the private management agent contract fees paid. A total of 30 firms submitted proposals, and the PRPHA awarded contracts to 15 management agents. We selected 4 of the 15 management agents to analyze the fees paid for fiscal year 2001. Those selected were GAR Housing, ERCO Enterprises, Housing Promoters, and Westbrook Management. We selected the two contracts with the highest direct costs, one contract due to concerns express by the PRPHA's former Finance Director, and one contract where the agent was indicted on fraud. For the contract where the agent was indicted, we only reviewed the non-project salaries, because the PRPHA took over the administration of the contract.

The results of our tests apply only to the sample selected and cannot be projected to the universe or population.

Our review generally covered the period July 1, 2000 through June 30, 2001. We extended the period as necessary. We performed our on-site work between August 2001 and April 2002. We provided a copy of our report to Honorable Ileana Echegoyen, Secretary, Puerto Rico Housing Department and Carlos Laboy, Administrator, Puerto Rico Housing Administration.

During the period covered by our review, John Blakeman III served as the PRPHA Administrator and Carlos Gonzalez served as Secretary of the Puerto Rico Department of Housing. We conducted our review in accordance with generally accepted government auditing standards.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PRPHA Disregarded Procurement Requirements

The PRPHA did not comply with Federal procurement requirements for the 1999 procurement of its public housing management agents. It did not properly document the use of valid and supported cost estimates, improperly released confidential information, used an inefficient ranking criteria, did not adequately support the performance of independent price or cost analyses for the proposals, and failed to maintain adequate procurement records. The PRPHA's former management disregarded Federal procurement requirements and failed to implement or ignored controls to plan, solicit, and award contracts. Irresponsibility by those officials of the PRPHA has proven to be financially detrimental to the PRPHA and unduly enriching to the private firms. The PRPHA's operating reserves for the low-rent program declined from $108 million in fiscal year 1999 to $25 million in fiscal year 2001 primarily because of the significant increase in the management fees paid to the management agents. The failed procurement resulted in financially burdensome management contracts which allowed excessive non-project salaries, overhead, and profit as discussed in further detail in Findings 2, 3, and 4.

Criteria

The Procurement Handbook for Public and Indian Housing Authorities, 7460.8 REV-1, Paragraph 2-1, states that regardless of the method used, Housing Authorities should plan their contracts in advance and attempt to obtain full and open competition to ensure that quality goods and services are obtained at a reasonable price. Paragraph 3-15, Section A (2) states that the independent cost estimate shall be used to evaluate the proposals and is considered confidential information not to be disclosed outside the Housing Authority. The reason for this protection is that contractors often bid the same as or less than the independent cost estimate, if known, as a means of securing a contract award without consideration of the true cost of a job. The preferred approach to procurement is to have each prospective contractor conduct an analysis and develop the offer independently.

Title 24 of the Code of Federal Regulations (CFR), Part 85.36 (c)(1) requires that all procurement transactions be conducted in a manner providing full and open competition. Part 85.36 (f)(1) requires the Authorities to perform a cost or price analysis in connection with every procurement action including contract modifications, regardless of the procurement method used. The method and degree of analysis is dependent on the facts surrounding the particular procurement situation, but as a starting point, Authorities must make independent estimates before receiving bids or proposals. A cost analysis must be performed when the offeror is required to submit the elements of his estimated cost, such as, under professional, consulting, and architectural engineering services contracts. Section (b)(9) requires the Authorities to maintain sufficient records to detail the significant history of each procurement.

The PRPHA's procurement regulations incorporated the Federal procurement requirements and imposed additional requirements making them more restrictive than HUD's requirements.

Cost estimate used was not valid or supported

The PRPHA used the fiscal year 1998-1999 operating budget to prepare the cost estimate for the procurement of the management agents. The analysis resulted in an estimated PUM management cost of $98 including $27 for the management fee. Although the PRPHA calculated the estimate at $98, the estimate was raised to $115 for ranking purposes. The PRPHA could not, however, provide support for the increase. A PRPHA budget official explained that Certified Public Accountant, Cardona Irizarry, a PRPHA contractor running the PRPHA accounting department at the time, simply advised management that the per unit figure should be increased to $115. The former PRPHA Administrator told us that the original amount was revised since additional expenditures, such as social workers, were not included in the fiscal year 1998-1999 budget estimate. He also admitted that he expected the PRPHA to receive additional funding within the next 3 years and that the PRPHA could afford to pay higher management fees.

Improper disclosure of confidential information

Prior to receiving the proposals, the PRPHA improperly informed the bidders of the maximum PUM cost that would be accepted. This was done through two addendums to the Request for Proposal. The first, Addendum IV, dated January 4, 1999, established a maximum management cost per unit at $115. Oddly, a subsequent Addendum VII, dated January 23, 1999, stated that although the maximum management cost per unit would be $115, a proposal would not be disqualified if the per unit cost exceeded this maximum. These disclosures violated HUD Handbook

7460.8, Paragraph 3-15, Section A (2) since they tainted the costs analyses of the various bidders and reduced price competition. Consequently, the PRPHA did not assure services were obtained at the most advantageous terms to the Federal government.

The ranking process and cost analysis were flawed

The ranking criteria used by the PRPHA assigned a maximum of 10 points to the management fee component. Four of the 10 points were to be given if the bidder submitted the required information, and the other 6 points were assigned if bidders unit cost was within the $115 range established by the PRPHA. Thus, only 6 of a total of 100 points were related to cost, making this factor virtually irrelevant. Furthermore, the PRPHA failed to adhere to its maximum per unit cost when it awarded contracts to 13 of the 15 winning bidders at amounts higher than $115 per unit cost. Those selected by the PRPHA were awarded per unit costs ranging between $106 and $147.

Office of Management and Budget Circular A-87, Attachment A, Paragraphs C (1) and C (2), states that for costs to be allowable they must "be necessary and reasonable for proper and efficient performance and administration of Federal awards." It also states that a cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining the reasonableness of a given cost, consideration shall be given to "market prices for comparable goods or services."

We concluded the PRPHA either failed to perform price/cost analyses for the procurement of the management agents' contracts or it ignored them. Had the PRPHA analyzed the bids, it would have discovered items of cost completely unnecessary and unreasonable, as follows:

- **Unreasonable profit** Some costs proposals included allowances for profit that were excessive. For example, NFC Inc. included an allowance for profit of $5,468,400, which was equal to 118 percent of the $4,619,396 in direct costs (non-project salaries and overhead). Title 41 U.S. Code, Section 254 (b) states that in the case of a cost-plus-a-fixed-fee contract the fee shall not exceed 10 percent of the estimated cost of the contract, exclusive of the fee. This is an example of what the Federal requirements consider reasonable. A prudent manager would consider 118 percent profit unreasonable. The other management agents had allowances for profit that ranged between 11 and 82 percent.

- **Project operating costs were improperly included in management costs** The president of GAR Housing admitted that his cost proposal included project operating costs as part of the management costs as follows:

Description	Amount
Resident Initiative	$2,099,035
Security	520,404
Elevator Maintenance	272,702
Cistern Maintenance	109,081
Emergency Generator Maintenance	109,081
Legal Services	520,404
Computer Maintenance	156,121
Total	$3,786,828

The improper inclusion would have been obvious to the PRPHA if a proper cost analysis had been performed as required. The proposal of GAR Housing and the eventual contract award were overstated by at least $3.7 million. The operating costs charged by GAR were not allocable to the management service fees, and contrary to Office of Management and Budget Circular A-87, Attachment A, Paragraph C (3)(a). Therefore, we estimated that, as of September 4, 2002, GAR received $2,007,019 of the $3.7 million contracted improperly.

- **Excessive salaries** Management agents submitted cost proposals with excessive non-project salaries. The salaries proposed were higher than the $79,992 salary of the PRPHA's own Administrator, who oversees the operations of all public housing projects in Puerto Rico. Examples of these excessive salaries are as follow.

Managing Firm	Position	Annual Salary (FY 2000-01)
ERCO Enterprises	General Manager	$421,762
ERCO Enterprises	Assistant General Manager	$321,048
GAR Housing	General Manager	$112,195
Housing Promoters	President	$122,416
American Management	President	$119,685

- **Donations** The cost proposals submitted by Westbrook Management and Nereida Falto de Cole Inc. included donations of $16,320 and $12,000, respectively, as part of their overhead expenses for fiscal year 2000-2001.

Procurement records were incomplete

The PRPHA's procurement records were incomplete and did not provide adequate documentation to support the significant history of the procurement process for the management agents. The PRPHA did not retain the rating sheets used by the Adviser Committee members to evaluate the various proposals. The Adviser Committee President explained that the rating sheets were considered internal documents that should not be disclosed because they contained comments of the evaluator. However, the rating sheets were the basis for contractor selection or rejection and constituted key pieces of evidence of the procurement history. It was the PRPHA's duty to conduct its procurements in a manner that provided full and open competition. It was also the PRPHA's duty to ensure the basis for its selections were available for public inspection, so that the fairness and openness of the process could be independently verified. Other missing records included the support of the PRPHA's cost estimate and minutes of the first pre-bid meeting. The procurement documentation provided by the PRPHA were photocopies, not originals, which were unorganized and tied up in bundles. Based on how the source documents were maintained, we had no assurance the PRPHA's records were complete.

Auditee Comments

Excerpts from the Authority's comments on our draft finding follow. Appendix E contains the complete text of the comments.

"PRPHA joins with the OIG to urge HUD to take appropriate action against all PRPHA or HUD officials, past or current, whose conduct violated or permitted the violation of applicable regulations and the sound administration of federal funds. Further, PRPHA offers its cooperation in any investigation that HUD or the OIG or any other Federal or State agency may undertake in this matter. . . .

"The PRPHA has sent a demand letter to GAR Housing Corporation (GAR) for the amount of $1,909,510. This amount was determined following an agreed upon procedures report performed by a CPA firm at the PRPHA's request and differs slightly from OIG's estimate. In addition, the PRPHA has determined that GAR's violations of its contractual obligations and performance warrants a termination of the contract for cause. To do so, we have requested HUD's concurrence for such termination. . . .

"PRPHA does not agree that the monies collected should be reimbursed to HUD. The funds expended on the contract with GAR are Federal funds allocated by HUD to the PRPHA as part of its operating subsidy. Therefore, any money collected should be vested in the PRPHA and used for the PRPHA to make it whole.

"The [Management Controls] section of the report identifies a number of significant weaknesses concerning the procurement of the management agents' contracts. We believe that these refer to the actions of the former Administration of the PRPHA. . . . Under the current Administration, PRPHA has improved its procurement processes and its management controls. These improvements have been possible, in part, due to HUD's technical assistance in the procurement area. . . .

"The draft report is silent on HUD's performance or lack of performance in connection with the subject procurement and contract administration, although it certainly presents a major issue. . . ."

OIG Evaluation of Auditee Comments

The PRPHA generally agreed with the finding. We acknowledge the PRPHA's efforts to collect excessive charges made by GAR Housing. However, the funds should be reimbursed to HUD, which in turn will determine the final disposition of program funds.

We recognize the fact that HUD has provided technical assistance in the procurement area to the PRPHA. However, our review did not include an assessment of the procurement practices under the current PRPHA's administration. Therefore, we cannot make any references to possible improvements in the procurement area.

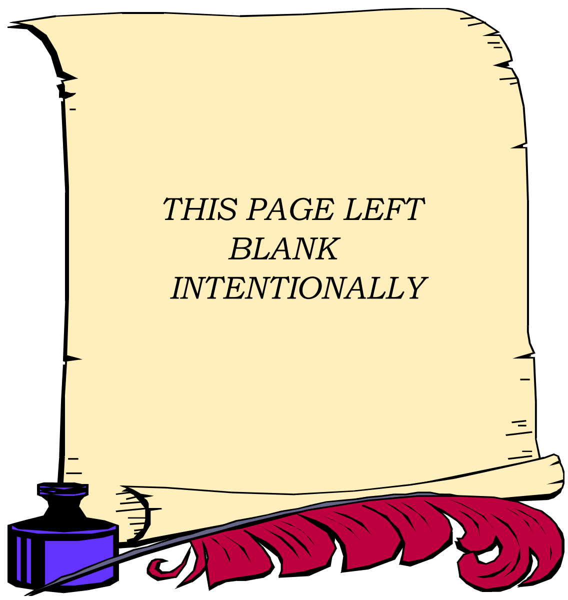
We concur with the PRPHA. HUD should have taken action in connection with the contract procurement. HUD's former Public Housing Director concurred that the amounts awarded were not consistent or reasonable, but did not take any action towards the contracted amounts. She claimed that it was the PRPHA's responsibility to ensure the reasonableness of the costs. If HUD had taken a more aggressive approach, the burdensome contracts may have been avoided.

Recommendations

We recommend that you:

1A. Consider appropriate administrative action against the former PRPHA Administrator and others for the gross mismanagement of the management agent procurement process.

1B. Require the PRPHA to deduct $2,007,019 from GAR's invoices to correct the operating costs improperly included in the proposal and contract award and reimburse the funds to HUD.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PRPHA Executed Financially Burdensome Management Contracts

As discussed in Finding 1, the PRPHA's management controls failed to ensure that contracts awarded to management agents in April 1999 were in the best interests of the PRPHA, its residents, or the taxpayer. The PRPHA executed unreasonable, erroneous, and burdensome contracts with management agents that adversely impacted the PRPHA's financial solvency. The PRPHA contracted for management of its public housing units at rates higher than previous years' contracts and higher than what other authorities paid by allowing their management agents to include excessive salaries, overhead, and profit. We attribute this to the former PRPHA Administrator's disregard of duties. As of September 30, 2002, the PRPHA possibly overpaid for management services by approximately $24.5 million and could incur additional excess costs of over $10.8 million if corrective actions are not taken.

Criteria

Office of Management and Budget Circular A-87 states that for costs to be allowable they must "be necessary and reasonable for proper and efficient performance and administration of Federal awards." It also states that a cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. In determining the reasonableness of a given cost, consideration shall be given to "market prices for comparable goods or services."

HUD Handbook 2210.18, Cost Principles For-Profit Organizations, Appendix 1, provides HUD grantees with applicable cost principles.

PRPHA's financial solvency at risk

In a letter dated November 13, 2001, HUD raised concerns about the PRPHA's financial condition. HUD stated that the PRPHA's operating reserves for the low-rent program declined from $108 million in fiscal year 1999 to $25 million in fiscal year 2001, and its projected cumulative operating reserves deficit for fiscal years 2002 to 2005 was $121 million. A well-managed housing authority generally maintains a reserve level of at least 30 percent of its perating costs, which should equal approximately $43 million for the PRPHA. HUD cited one of the primary reasons for the substantial decline was the significant increase in the management fees paid to the management agents.

We analyzed the fiscal years 2000-2004 management agent contracts in three ways: (1) comparing them to prior years' contracts, (2) examining the expenditures of three of the management agents, and (3) comparing them to the fees paid by other housing authorities.

Management fees were higher than in years' past

The PRPHA's records reflected an increase in management fees paid when new management contracts were awarded in 1999. Payments made to management agents under the 1995 contracts, which were in effect until April 30, 1999, had an average monthly payment of $1,453,834. When the new contracts were awarded in 1999, the average monthly payment increased to $2,074,945. The monthly management fees increased by $621,112, or 43 percent. The schedule below shows the increasing trend in management fees incurred by the PRPHA.

Period	Total Management Fee	Average Monthly Fee	Percentage Change
FY 1997-98 (Old Contracts)	$17,750,365	$1,479,197	N/A
FY 1998-99 (Old Contracts- 10 mo. period)	$14,538,342	$1,453,834	(2)
FY 1998-99 (New Contracts- 2 mo. period)	$4,149,891	$2,074,945	43
FY 1999-2000 (New Contracts)	$25,586,510	$2,132,209	3
FY 2000-01	$27,011,865	$2,250,989	6

During the 1999 procurement process, 13 management agents were retained from the 1997-1998 contracts and awarded new contracts, and two new management agents were awarded contracts to manage the public housing projects. We compared the PUM management fees awarded to the 13 management agents under the old fiscal year 1997-1998 contracts with the new fiscal year 2000-2001 contracts. We found that the PUM management fees for each of the 13 management agents increased when the new contracts were executed. The increase ranged from 13 percent to 156 percent, as shown below.

	Old Contracts FY 1997-1998		New Contracts FY 2000-2001		
Management Agent	Units	Management Unit Fee	Units	Management Unit Fee	Percentage Increase
Comite Gericola (NFC)	3,170	$18	3,559	$46	156
Housing Promoters	3,939	27	3,531	47	74
American Management	3,850	25	3,599	50	100
SP Management	3,144	27	3,866	36	34
A&M Contractors	3,046	30	3,870	40	34
Cost Control	3,031	28	3,523	37	33
Miramar Construction	3,610	28	3,611	44	58
ZETA Enterprises	3,278	22	3,984	31	41
MJ Consulting	3,995	29	4,017	39	35
Martinal Property	2,025	33	3,602	38	16
Westbrook Management	2,675	28	3,814	38	36
JA Machuca & Assoc.	2,668	25	3,836	32	28
Peregrine Management	3,209	32	3,832	36	13

These increases were higher than the annual inflation rate of Puerto Rico which was between 5.1 percent and 5.7 percent from 1996 to 2000. The cumulative inflation percentage for the years 1998 through 2000 was about 18 percent. Therefore, considering the inflation for the economy of Puerto Rico, the increased PUM management fees for 11 of the contracts were above the cumulative inflation rate, ranging between 28 and 156 percent.

The former PRPHA Administrator made the decision to enter into the management agent contracts without apparent or documented reasons to justify the large percentage increases. This increasing trend in the management fees incurred by the PRPHA has affected the resources of the public housing programs. In addition, the former Administrator's contracting decisions unjustly enriched the management agents.

Fees included unreasonable and unnecessary expenses

Our assessment of accounting records of GAR Housing, Housing Promoters, and Westbrook Management showed that the three agents included costs in their fee proposals that were excessive or otherwise improper. The following table shows our computation of the reasonable and necessary costs for which the PRPHA should have contracted. Our analysis resulted in substantial reduction in the management fees for all three agents reviewed.

	Amount Awarded by PRPHA	Amount Disbursed by PRPHA	Amount Estimated Reasonable Per OIG	
GAR Housing	**Fiscal Year 2000-2001**			
Non-Project Salaries	$943,153	$943,153	$783,150	
Overhead Allowance	1,016,594	1,016,594	311,162	
Profit Allowance	391,949	391,949	109,431	
Total Management Fee	$2,351,696	$2,351,696	$1,203,743	(See Appendix B)
Per Unit Month Fee	$55		$28	
Housing Promoters	**Fiscal Year 2000-2001**			
Non-Project Salaries	$1,085,634	$1,063,649	$638,356	
Overhead Allowance	522,942	522,942	290,765	
Profit Allowance	386,505	386,505	92,912	
Total Management Fee	$1,995,081	$1,973,096	$1,022,033	(See Appendix C)
Per Unit Month Fee	$47		$24	
Westbrook Management	**Fiscal Year 2000-2001**			
Non-Project Salaries	$917,923	$879,522	$836,553	
Overhead Allowance	634,563	613,121	292,741	
Profit Allowance	190,222	190,222	112,929	
Total Management Fee	$1,742,708	$1,682,865	$1,242,223	(See Appendix D)
Per Unit Month Fee	$38		$27	

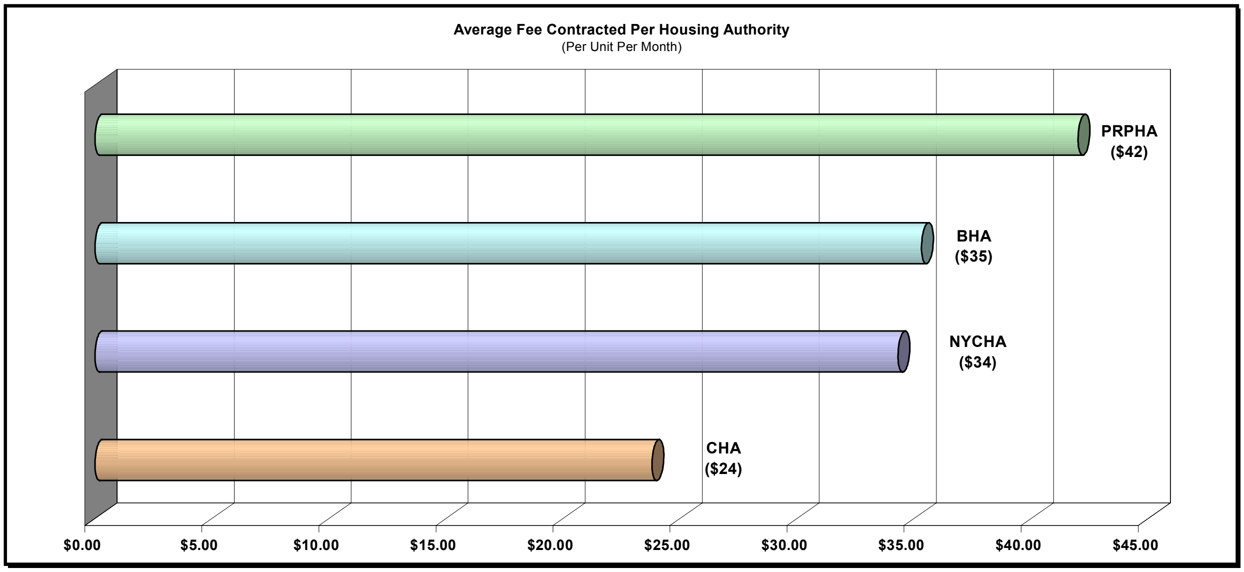
GAR Housing's excessive fees were $1,147,953 or 49 percent of the approved amount. Housing Promoters' excessive fees were $973,048 or 49 percent of the approved amount. Westbrook Management's excessive fees were $500,485 or 29 percent of the approved amount. This analysis shows that the PRPHA awarded $2,621,486 in unnecessary fees for three of its management agents for fiscal year 2000-2001.

We applied the excessive percentages to the total management fees approved by the PRPHA and projected excessive fees of $13.9 million for fiscal years 2000-2004 as follows:

Managing Firm	Total Management Fees	Percentage Determined Excessive	Excessive Amount
GAR Housing	$12,432,414	49	$6,091,883
Housing Promoters	10,624,332	49	5,205,923
Westbrook Management	9,242,772	29	2,680,404
Total			$13,978,210

PRPHA's management fees were not comparable to other housing authorities

The PRPHA contracted the management of its public housing units at rates higher than the rates contracted by the Chicago Housing Authority, New York City Housing Authority, and Boston Housing Authority. The three housing authorities average contract fees were much lower, ranging from $24 to $35 per unit, while the PRPHA's average contract fee was $42 per unit, as shown below.



The total average PUM management fee in Chicago, New York City, and Boston was $31. The average PUM management fee in Puerto Rico was $42, a difference of $11. Applying this excess to the 5-year contracts at the PRPHA shows that the PRPHA could have saved over $35 million. As of September 30, 2002, the PRPHA possibly overpaid for management services by approximately $24.5 million. The PRPHA will incur additional unnecessary costs of another $10.8 million if corrective actions are not taken.

Unlike other housing authorities who paid their management agents according to the calculated per unit month fee, the PRPHA contracts required the management agents to invoice the PRPHA based on their management cost schedules. The management cost schedules included the four categories: (1) non-project salaries and benefits, (2) overhead, (3) profit, and (4) project salaries and benefits. The management agents billed the PRPHA for each line item monthly rather than on the calculated per unit month fees. Consequently, the PRPHA's agents were paid in full, without deductions for vacant units.

The management contracts contained a provision that allows the PRPHA to cancel the contracts. Paragraph 18.1.3 of the contracts states that the PRPHA may terminate the agreement for convenience with HUD's concurrence, in whole or in part, whenever the PRPHA determines that such termination is in its best interest. The PRPHA shall terminate the agreement by delivering to the management a fifteen (15) day notice of termination specifying the extent to which the performance of the services under the agreement is terminated, and the effective date of such termination.

PRPHA and HUD need to take steps immediately to stop the drain on the PRPHA's much needed funds.

Auditee Comments

Excerpts from the Authority's comments on our draft finding follow. Appendix E contains the complete text of the comments.

"PRPHA has already started its efforts to remedy the deficiencies in those contracts and will pursue all available options to ensure that its best interest and those of HUD are being served. On October 9, 2001, the PRPHA sent letters to the Management Agents indicating that they needed to support their Management Fee invoices. Since then, the PRPHA has reduced the amount requested by approximately $1.1 million for disallowed costs. The request has also resulted in additional savings in an amount of approximately $860,00 because some Management Agents have not incurred overhead costs equal to the amount that had been budgeted for them.

"The PRPHA is now negotiating amendments to the contracts with the Management Agents with the principal objectives of reducing the per unit management fees and basing compensation on a per-occupied-units fee. . . . If the Management Agents are not willing to negotiate, the PRPHA will seek HUD's concurrence to cancel the corresponding contract for convenience.

"Furthermore, the PRPHA has also filed a Declaratory Judgment action against the fourteen (14) Management Agents. This action seeks a determination that the contracts are reimbursement based. . . . If the determination of the Court is as the PRPHA expects, the PRPHA will contract with CPA firms to perform a forensic audit of the Management Agent management Fee expenses.

"Finally, it should be noted that as soon as. . . the President of ERCO Enterprises (one of the original fifteen (15) Management Agents) was indicted, the PRPHA immediately cancelled ERCO's contract. . . . As a result, PRPHA has saved approximately $5 million. Thus the total savings obtained from the actions taken to date has been approximately $7 million as of December 31, 2002. . . ."

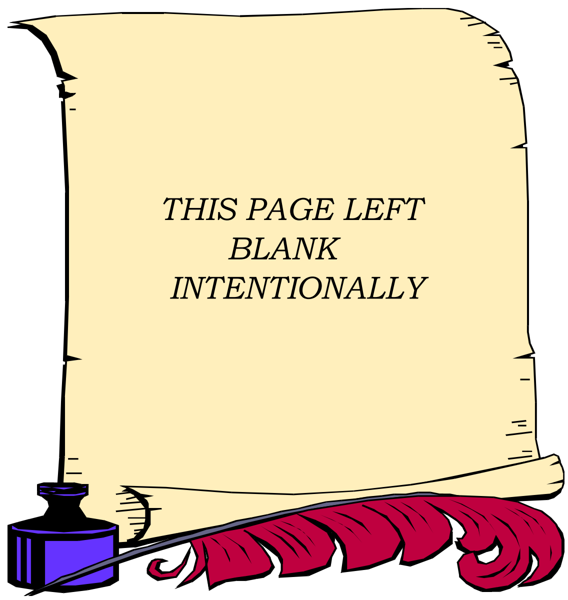
OIG Evaluation of Auditee Comments

The PRPHA agreed with the finding. We acknowledge the PRPHA's efforts to remedy the deficiencies in the contracting of the management agents. We believe the PRPHA's actions will remedy the contract deficiencies.

Recommendation

We recommend that you:

2A. Work with the PRPHA to remedy the deficiencies in the contract, or require the PRPHA to pursue all available options provided by the agents' service contracts to ensure the best interests of the PRPHA and HUD are being served, and possibly save $10,824,363 of costs not incurred.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Non-Project Salaries and Benefits Were Excessive

Non-project salaries and benefits was one of the three management fee components paid by the PRPHA. The charges were based on payroll expenditures incurred by non-project personnel. The non-project salaries paid to GAR Housing, Westbrook Management, and Housing Promoters during fiscal year 2000-2001 totaled $2,886,324. We reviewed the non-project salaries charged by the three management agents and identified that the management agents charged over $423,646 for items that were excessive, were not allocable to the public housing program, or violated the management contract. We attribute the above deficiencies to the PRPHA's failure to conduct price/cost analyses of the cost proposals. As a result, an unnecessary burden was placed on the PRPHA and the taxpayers**.**

Criteria

HUD Handbook 2210.18, Cost Principles For-Profit Organizations, states that while a fixed-price contract (i.e., a contract that provides for a price that is not subject to any adjustment as a result of the contractor's cost experience in performing the contract) may be the result of the competitive proposal method of procurement, you will still be required to apply the cost principles to determine cost reasonableness. However, the application of the cost principles to fixed-price contracts does not require you to negotiate on individual elements of costs in arriving at an agreement on total price. Although use of these cost principles is mandatory, the objective is to negotiate prices that are fair and reasonable, cost and other factors considered.

Office of Management and Budget Circular A-87 states that costs must be reasonable. In determining the reasonableness of a given cost, consideration shall be given to:

- Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award.
- The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining; Federal, State, and other laws and regulations; and terms and conditions of the Federal award.

Management agents reviewed

We identified excessive charges related to the non-project salaries and benefits of GAR Housing, Housing Promoters, and Westbrook Management for fiscal year 2000-2001, as follows:

1. GAR Housing

The PRPHA approved a budget of $943,153 for GAR Housing's non-project salaries. The management agent did not provide the basis used to determine the salaries included in its cost proposal. We determined the following expenditures violated the management contract, were excessive, or were not allocable to the public housing program.

- **Non-project positions** GAR Housing did not maintain all positions approved by the PRPHA and required by the management contract. The cost proposal included two accountant and two secretary positions, but it only had one of each. In addition to the positions included in the cost proposal, GAR Housing billed the PRPHA for other positions that were not part of the cost proposal. Although the agent charged the PRPHA for the other positions, it did not exceed the total amount approved for non-project salaries.

- **Non-project surplus** The June 30, 2001 trial balance reflected non-project salaries income of $943,153 received from the PRPHA, while the expenditures were $862,652, resulting in a surplus of $80,501. Therefore, the PRPHA paid the management agent for costs it never incurred, as shown below:

Trial Balance as of June 30, 2001

Account	Debit	Credit
Income Non-Project Salaries		$943,153.29
Administrative Salaries Non-Project	$682,876.30	
Social Security Expense Non-Project	59,626.36	
Disability and Chauffeur Non-Project	517.34	
FUTA Non-Project	1,151.70	
SUTA Non-Project	5,373.98	
Bonus Expense Central Office	31,670.35	
Vacation Expense Non-Project	41,829.32	
Medical Expense Non-Project	17,970.07	
Workmen Compensation Expense	21,636.97	
Total	$862,652.39	$943,153.29
Surplus		$80,500.90

- **Compensation to immediate family** The President of GAR's sons were non- project employees. An identity-of-interest firm doing business with the management agent employed the President's wife and another son. Also, another son was providing legal services to the projects and paid from project operating funds. We noted that the son hired as the MIS Director was paid $5,000 monthly and did not meet the job requirements. Per the PRPHA, the minimum education and experience required for the position was a Bachelors degree in Computer Information Systems and four years of experience in analysis and computer programming, which he did not have.

  Paragraph 20.15.5 of the management agreement states that "management agents will not contract for any services or goods with (a) any entity in which any shareholder, partner, principal, officer of director of the management agent, has an interest, (b) any employee of the management agent, (c) any person related to the management agent by blood or marriage, and (d) any entity controlled by or under common control with the management agent, unless authorized in writing by the PRPHA." However, written authorization was not obtained.

2. Housing Promoters

The PRPHA approved a budget of $1,085,634 for Housing Promoters' non-project salaries. The management agent did not provide the basis used to determine the salaries included in its cost proposal. It was observed that during the years prior to the 1999 contract, payroll expenditures increased about 2 percent per year. However, when the new contract was awarded, payroll expenditures increased about 30 percent. Furthermore, the PUM fee under the 1995 contract averaged about $27 and now the PUM fee is $50. These increases are considered unjustified, especially since the agent was administering more units under the 1995 contract (3,939 units-old contract; 3,531 units-new contract). Therefore, non-project salary charges were considered inflated by at least $319,095.

In addition, we determined the following expenditures violated the management contract.

- **Non-project position** Housing Promoters did maintain all positions approved by the PRPHA and required by its management contract. Although the total amount billed to the PRPHA did not exceed the amount approved for non-project salaries; we identified seven employees that were performing other functions not related to the public housing program, but the PRPHA was billed for their full salaries. The management agent did not allocate the costs for the activities non-related to the public housing program, and could not provide documentation for the time spent on the non-related activities. Therefore, we could not determine the actual amount improperly charged or allocated to the PRPHA.

3. Westbrook Management

The PRPHA approved a budget of $917,923 for Westbrook Management's non-project salaries. We determined the following related to its expenditures.

- **Non-project positions** Westbrook Management did not maintain all positions approved by the PRPHA. In the cost proposal, it included the positions of Tenant Opportunity Program Grant Technician and a second Finance Coordinator, but they were vacant during the entire year. In addition to the positions included in the cost proposal, Westbrook billed the PRPHA for other positions that were not part of the cost proposal. Nevertheless, the non-project salaries did not exceed the approved budget amount.

- **Invoice review** Westbrook included car allowance expenditures of $32,450 in its non-project salaries. The allowances paid to officials ranged from $250 to $500 per month as follows:

POSITION	AMOUNT
General Manager	$500
Project Director	500
Maintenance Director	500
Finance Director	400
Resident Program Director	400
Occupancy Director	400
Sports & Home Ownership	250
Total Monthly Charge	$2,950

Appendix 1, Part 31.205-46 of HUD Handbook 2210.18, Cost Principles For-Profit Organizations, states that the cost for transportation may be based on mileage rates, actual costs incurred, or a combination. It does not permit allowances. Although the officials received a car allowance, Westbrook paid its other staff 30 cents per mile for mileage on a reimbursement basis. Therefore, the monthly car allowances charged were excessive and we determined $24,050 charged during fiscal year 2001 was not allowable.

Westbrook Management included a Security Coordinator's position in its cost proposal. The approved monthly salary was $3,700. Under a professional service contract, Westbrook contracted a lieutenant from the Puerto Rico State Police at a monthly rate of $2,750, which represented a conflict of interest. A special waiver was required for the lieutenant to perform the contracted work; however, a waiver was not obtained. Also, the security services of the Security Coordinator were contracted without any procurement.

Overall, the management agents did not adhere to the terms of the management contracts. The agents charged the PRPHA $423,646, as shown below, for expenditures that were excessive or not allocable to the public housing program. As a result, the PRPHA paid for items that affected the limited resources of its public housing program.

Non-Project Salary Expenditures	Amount Excessive or Not Allocable
GAR Housing	
Non-Project Surplus	$ 80,501
Housing Promoters	
Excessive Salaries	$319,095
Westbrook Management	
Car Allowance	$ 24,050
Total	$423,646

We attribute these deficiencies to the PRPHA's disregard of the Federal procurement requirements and its failure to implement controls to plan, solicit, and award contracts. In addition, the PRPHA did not perform price/cost analyses of the cost proposals.

Auditee Comments

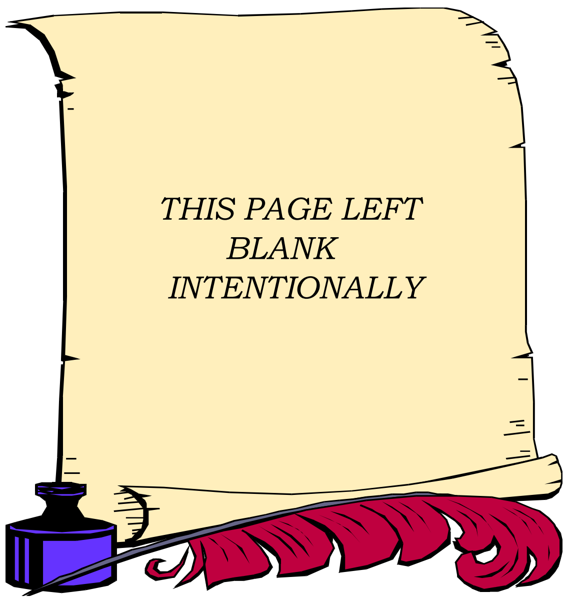
"PRPHA joins with the OIG to urge HUD to take appropriate action against all PRPHA or HUD officials, past or current, whose conduct violated or permitted the violation of applicable regulations and the sound administration of federal funds. Further, PRPHA offers its cooperation in any investigation that HUD or the OIG or any other Federal or State agency may undertake in this matter. . . ."

OIG Evaluation of Auditee Comments

The PRPHA agreed with the finding. We believe the PRPHA's actions and cooperation will address the deficiencies.

Recommendation

3A. See Recommendation 1A.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Overhead and Profit Were Excessive

Overhead and profit were the remaining two management fee components paid by the PRPHA. The overhead charges were billed as a fixed monthly or semi-monthly amount based on the approved budget, regardless of the actual overhead expenditure incurred during the billing period. The overhead allowance paid by the PRPHA during fiscal year 2000-2001 to GAR Housing, Housing Promoters, and Westbrook Management totaled $2,152,657. We identified that the management agents incurred overhead expenditures of over $1,047,633 that were excessive, were not allowable and/or allocable to the public housing program, or violated the management contract. The expenditures included payments to identity-of-interest firms, purchase of gifts and flower arrangements, social gathering, and donations.

The management agents' profit contracted for the 5-year period was $36,294,643 and this also was excessive. The management agents did not have uniformity or consistency for the contracted profits. Although each management agent had about the same number of units, the profit approved or charged was not within the same ranges. We projected that the excessive profit would exceed $25 million for the 5-year contract period.

We attribute the above deficiencies to the PRPHA's failure to conduct price/cost analyses of the cost proposals.

Criteria

HUD Handbook 2210.18, Cost Principles For-Profit Organizations, states that while a fixed-price contract (i.e., a contract that provides for a price that is not subject to any adjustment as a result of the contractor's cost experience in performing the contract) may be the result of the competitive proposal method of procurement, you will still be required to apply the cost principles to determine cost reasonableness. However, the application of the cost principles to fixed-price contracts does not require you to negotiate on individual elements of costs in arriving at an agreement on total price. Although use of these cost principles is mandatory, the objective is to negotiate prices that are fair and reasonable, cost and other factors considered.

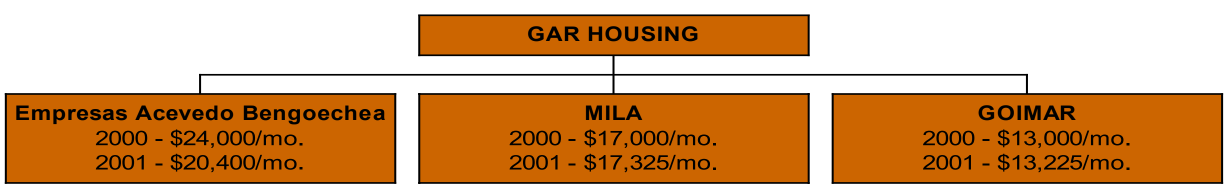
Management agents overhead allowance

We identified charges that were excessive, unallowable, and unallocable or violated the management contract that related to the overhead allowances of GAR Housing, Housing Promoters, and Westbrook Management for fiscal year 2000-2001.

1. GAR Housing

The PRPHA approved a budget of $1,016,594 for GAR Housing's overhead. We determined the following expenditures either violated the management contract, were not allowable, or not justifiable.

- **<u>Contracts with identity of interest firms</u>** GAR Housing executed professional service contracts with three identity-of-interest firms without mediating a procurement process or obtaining prior written approval from the PRPHA. Paragraph 20.15.5 of the management agreement states that "management agents will not contract for any services or goods with (a) any entity in which any shareholder, partner, principal, officer of director of the management agent, has an interest, (b) any employee of the management agent, (c) any person related to the management agent by blood or marriage, and (d) any entity controlled by or under common control with the management agent, unless authorized in writing by the PRPHA." The following contracts were improperly executed.



Identity of Interest Officials

GAR HOUSING
Rafael Acevedo Feliciano, President
Rafael Acevedo Bengoechea, Vice-President (1)
Roberto Acevedo, Secretary (2)
Leandro Goicoechea Calas, Treasurer

MILA
Leandro Goicoechea Calas, President & Treasurer
Milagros Lamot, Vice-President & Secretary

EMPRESAS ACEVEDO BENGOECHEA
Rafael Acevedo Feliciano, President
Rafael Acevedo Bengoechea, Vice-President (1)
Luis Acevedo Bengoechea, Treasurer
Roberto Acevedo, Secretary (2)
Mario Acevedo, Sub-Treasurer

GOIMAR
Leandro Goicoechea Lamoutte, President & Treasurer
Giselle Martin, Vice President & Secretary

Notes:
(1) Currently GAR's Vice-President of Operations and full salary charged to the PRPHA
(2) Currently MIS Director and full salary charged to the PRPHA

The cost proposal submitted by GAR Housing listed seven types of contracts dealing with resident initiatives, security, elevator maintenance, cistern maintenance, legal services, computer maintenance, and the emergency generator for a total budget of $3.7 million. However, GAR did not execute a contract for the purposes listed, instead it contracted the identity-of-interest firms for other intentions. GAR Housing's President stated that the $3.7 million included in the proposal pertained to project operating costs; nevertheless the PRPHA approved the amounts as part of management fees. Therefore, the cost proposal submitted by GAR Housing contained misleading information resulting in an overstatement of the contracted amount.

The nature of the services contracted with the identity-of-interest firms for all three contracts was vague and the scope of services was identical. The services included:

- Management consultant for corporations dedicated to housing management.
- Civil engineer consultant.
- Public housing projects management and supervision consultant.
- Public or subsidized housing management and development consultant.
- Consultant for the acquisition, purchase of movable and immovable property, and the contracting of professional services under the federal regulation.

The contract with Empresas Acevedo had an additional clause for its President to also act as the president of GAR Housing. The services of the identity-of-interest contracts were the same services GAR Housing was originally contracted to perform.

The source of the funds for the identity-of-interest firms was from the overhead and profit allowances approved in the management contract executed with the PRPHA. The payments to the identity-of-interest firms during fiscal year 2001 were as follow:

ENTITY	OVERHEAD	PROFIT	TOTAL
EMPRESAS ACEVEDO	$174,580	$112,450	$287,030
MILA	142,246	53,080	195,326
GOIMAR	97,568	50,411	147,979
Total	**$414,394**	**$215,941**	**$630,335**

The PRPHA, as required by the management contract, did not authorize the contracts with the identity-of-interest firms. Furthermore, they were excessive and unnecessary for the administration of the public housing projects.

- **<u>Costs not allowable</u>** GAR Housing charged costs that were prohibited by the management contract or program regulations. Among the charges were: (a) $13,285 interest and penalties on its tax returns; (b) $38,075 for insurance premiums for fidelity and performance bonds; and (c) $17,303 for entertainment purposes (gifts, food, Christmas party, etc.).

- **<u>Costs not incurred</u>** GAR Housing provided a detail of the overhead income and expenditures for the period ending June 30, 2001. It reflected overhead income of $1,016,594 received from the PRPHA and overhead expenditures of $889,340. Therefore, GAR Housing billed the PRPHA at least $127,254 for expenditures that were not incurred under the overhead costs category.

2. Housing Promoters

The PRPHA approved a budget of $522,942 for Housing Promoters' overhead. We determined the following expenditures were not allocable, allowable, justifiable, or were prohibited by the management contract.

- **No cost allocation** Housing Promoters performed other endeavors unrelated to the public housing program, such as the administration of Section 8 units, lease of commercial facilities, and a real estate business involving the purchase of land for housing development. However, it made charges to the public housing activities expenditures, such as rent, utilities, and office expenses without properly allocating the costs among the unrelated housing program activities. It also included transactions with identity-of-interest entities. We estimated $54,699 in costs that were not allocable. Therefore, Housing Promoters was subsidizing its private endeavors with public housing funds and limiting the resources for eligible activities.

- **Costs not allowable** Housing Promoters charged costs that were excessive or prohibited by the management contract or by program regulations. Among the charges were: (a) $14,500 for a Christmas party; (b) $431 related to the Section 8 program; (c) $419 for residential phone services; and (d) $7,302 in excessive rent charged by an identity-of-interest entity.

- **Car allowance** The overhead account included car allowance expenditures of $52,500 that was paid to 12 officials. The allowance paid to some officials ranged between $150 and $1,200 per month as follows:

Position	Amount
President	$1,200
Executive VP	600
Operations Director	350
Manager Are Office 4	350
Social Worker Supervisor	325
Comptroller	300
Monitoring Director	300
Sub-Manager-Bayamon	300
Human Resources Director	250
Monitoring Technician	250
Engineer Assistant	250
Purchases Supervisor	150
Total Monthly Charge	**$4,375**

Appendix 1, Part 31.205-46 of HUD's Handbook 2210.18, Cost Principles for For-Profit Organizations, states that the cost for transportation may be based on mileage rates, actual costs incurred, or a combination. The Handbook does not permit allowances.

Although these officials were receiving a car allowance, Housing Promoters made payments to other staff for mileage on a reimbursement basis. The monthly car allowance charged is considered excessive and we determined $38,100 charged during fiscal year 2001 was not allowable.

3. Westbrook Management

The PRPHA approved a budget of $634,562 for Westbrook Management's overhead. We determined the following expenditures were either not allowable or justifiable.

- **Contracts with identity-of-interest firms** Westbrook Management contracted its parent company (Burke Properties) for consulting services up to $350,000, but did not obtain the PRPHA's approval as required in the management contract. Paragraph 20.15.5 of the management agreement states that "management agents will not contract for any services or goods with (a) any entity in which any shareholder, partner, principal, officer of director of the management agent, has an interest, (b) any employee of the management agent, (c) any person related to the management agent by blood or marriage, and (d) any entity controlled by or under common control with the management agent, unless authorized in writing by the PRPHA." The management services provided by Burke Properties were: (a) consulting on HUD regulations; (b) general administration; (c) consulting, advertising, and statistical services; (d) management operational decision making; and (e) any other related services required by Westbrook Management.

Westbrook accounting records reflected accounts payable to Burke Properties of $300,000 that were accrued as overhead expenses. Westbrook Officials stated that they were having cash flow problems. Therefore, Burke Properties was not cashing the checks issued.

The contract was unnecessary and unreasonable due to Burke Properties involvement in Westbrook's operations, which consisted of sporadic visits, while the general manager and staff ran the day-to-day operations. In addition, the contract was not properly approved by the PRPHA, which violated the management contract.

- **Costs not allocable** Westbrook Management charged costs that were excessive or prohibited by federal regulations. Among the charges were: (a) $9,770 for a Christmas party, including alcoholic beverages; (b) $2,783 in donations (political, state police, and pageants); (c) $1,698 in excessive rent charges; (d) $4,496 in duplicate costs; (e) $1,356 in flower arrangements; (f) $1,118 for a restaurant dinner; (g) $150 for three gourmet baskets for the mayor; and (h) $500 contribution for a farewell party and gift for the former PRPHA Administrator.

The management agents did not adhere to the terms of the management contract. The agents charged the PRPHA $1,047,633, as shown below, for overhead expenditures that were excessive or not allocable to the public housing program. As a result, the PRPHA paid for items that affected the limited resources of the public housing program.

Overhead Expenditures	**Amount Excessive, Not Allocable or Allowable**
GAR Housing	
Contracts With I-O-I	$414,394
Costs Not Allowable	68,663
Costs Not Incurred	127,254
Total	$610,311
Housing Promoters	
No Cost Allocation	$54,699
Costs Not Allowable	22,652
Car Allowance	38,100
Total	$115,451
Westbrook Management	
Contracts with I-O-I	$300,000
Costs Not Allocable	21,871
Total	$321,871
Grand Total	$1,047,633

Profit allowance

The management agents profit allowance ranges were between 11 percent and 118 percent of direct costs during fiscal year 2000-2001. Title 41 USC, Section 254 (b) states that in the case of a cost-plus-a-fixed-fee contract the fee shall not exceed 10 percent of the estimated cost of the contract, exclusive of the fee.

Using the percentage suggested, we determined that the PRPHA paid about $5 million in excessive profit. The schedule below shows a detailed comparison by agent and the excessive amount.

Agent	Region Number	Direct Costs: Non-Project Salaries & Benefits	Overhead	Total	Profit	Profit Percentage over Direct Costs	Allowable Profit per Title 41 USC (10%)	Excessive Profit
NFC, Inc	1	$ 533,557	$ 358,700	$ 892,257	$ 1,058,400	118.62%	$ 89,226	$ 969,174
SP Management	2	704,476	616,945	1,321,421	327,750	24.80%	132,142	195,608
American	3	960,181	559,750	1,519,931	657,540	43.26%	151,993	505,547
Housing Promoters	4	1,085,634	522,942	1,608,576	386,505	24.03%	160,858	225,647
Martinal	5	718,604	427,184	1,145,788	493,232	43.05%	114,579	378,653
A & M	6	689,552	332,467	1,022,019	835,920	81.79%	102,202	733,718
GAR	7	943,153	1,016,594	1,959,747	391,949	20.00%	195,975	195,974
Cost Control	8	760,287	415,800	1,176,087	384,000	32.65%	117,609	266,391
Peregrine	9	827,070	392,472	1,219,542	416,016	34.11%	121,954	294,062
Miramar	10	561,350	936,000	1,497,350	420,000	28.05%	149,735	270,265
ERCO	11	1,373,923	177,450	1,551,373	172,371	11.11%	155,137	17,234
MJ	12	744,726	601,735	1,346,461	513,146	38.11%	134,646	378,500
JA Machuca	13	617,400	309,000	926,400	558,132	60.25%	92,640	465,492
Westbrook	14	917,923	616,080	1,534,003	184,493	12.03%	153,400	31,093
Zeta	15	700,812	596,106	1,296,918	194,538	15.00%	129,692	64,846
Total		$ 12,138,648	$ 7,879,225	$20,017,873	$ 6,993,992	34.94%	$ 2,001,787	$ 4,992,205

We projected that the excessive profit allowance for the contract period would exceed $25 million as shown in the following table.

Five Year Period (May 1999 through June 2004)	
Non-Project Salaries	$ 64,411,711
Overhead	41,470,908
Total Direct Costs	$105,882,619
Profit (about 34 percent of direct costs)	$ 36,294,643
Total Management Fee	$142,177,262
Allowable Profit per Title 41 USC (10% of direct costs)	$ 10,588,262
Excessive Profit	$ 25,706,381

The profit allowance awarded to each management agent was excessive. As a result, the PRPHA paid for items that affected the limited resources of the public housing program.

Overall, we attribute these deficiencies to the PRPHA's disregard of the Federal procurement requirements and its failure to implement controls to plan, solicit, and award contracts. In addition, the PRPHA did not perform price/cost analyses of the cost proposals.

Auditee Comments

"PRPHA joins with the OIG to urge HUD to take appropriate action against all PRPHA or HUD officials, past or current, whose conduct violated or permitted the violation of applicable regulations and the sound administration of federal funds. Further, PRPHA offers its cooperation in any investigation that HUD or the OIG or any other Federal or State agency may undertake in this matter. . . ."

OIG Evaluation of Auditee Comments

The PRPHA agreed with the finding. We believe the PRPHA's actions and cooperation will address the deficiencies.

Recommendation

4A. See Recommendation 1A.

Management Controls

In planning and performing our audit, we considered the management controls of the Puerto Rico Public Housing Administration in order to determine our audit procedures and not to provide assurance on the controls. Management is responsible for establishing effective management controls to ensure that its goals are met. Management controls include the plan of organization, methods and procedures adopted by the management to ensure that its goals are met. Management controls include the processes for planning, organization, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Management Controls

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

- Procurement of management agent services; and
- Allowable costs/cost principles.

We assessed the relevant controls identified above by:

- Reviewing the regulations governing the program;
- Interviewing HUD, PRPHA and management agent officials;
- Reviewing procurement and cash disbursement records;
- Analyzing reviews and reports from Certified Public Accountant.

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

Significant Weaknesses

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

- The PRPHA did not follow procurement requirements in the contracting of management agents. (See Finding 1)

- Confidential information was released to bidders prior to the submission of proposals. (See Finding 1)

- The PRPHA executed financially burdensome contracts with management agents that were higher than other housing authorities. (See Finding 2)

- Management costs substantially increased depleting operating reserves and placing the PRPHA's financial solvency at risk. (See Finding 2)

- Comprehensive price/cost analyses were not performed. (See Finding 1 and Finding 2)

- The PRPHA incurred excessive non-project salaries and benefits. (See Finding 3)

- The PRPHA incurred excessive overhead and profit allowances. (See Finding 4)

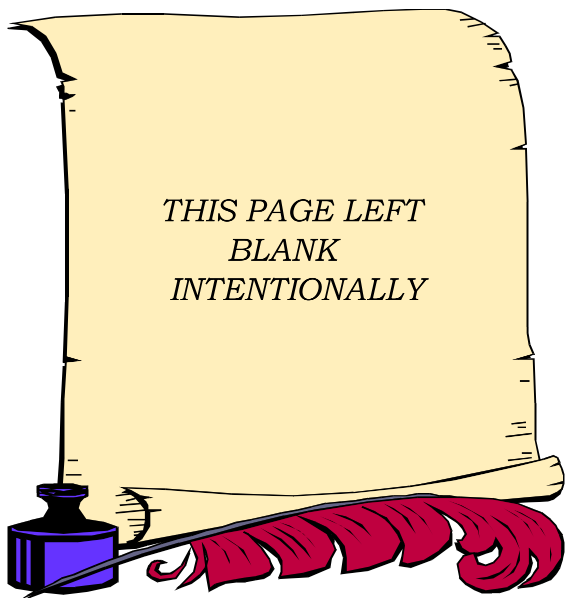
Follow-Up On Prior Audits

Prior audit reports contained findings that impact the objectives of this audit.

An Office of Inspector General for Audit's audit report (No. 00-AT-201-1003 dated March 6, 2000) on the PRPHA procurement administration concluded that the PRPHA: (1) did not comply with Federal and agency procurement requirements and did not maintain control over the central office procurement activities, (2) paid about $4.9 million more than necessary for professional services provided by two contractors that were contracted without competition and without performing price and/or cost analysis, (3) did not maintain effective management controls to deter waste, abuse, and fraud, and (4) did not maintain adequate inventory. The report contained 4 findings with 19 recommendations. At the time of this review, 14 recommendations were resolved.

An Office of Inspector General for Audit's audit report (No. 2001-AT-1005 dated March 30, 2001) on the PRPHA Housing Opportunities for People Everywhere (HOPE) VI Program concluded that the PHA: (1) failed to provide full and open competition when it awarded a sole source contract to the project manager of the Gateway project and did not perform a price or cost analysis, (2) project manager did not comply with Federal or the PRPHA's procurement requirements, (3) failed to properly administer payments of the Comprehensive Grant Program funds assigned to the Gateway project, and (4) had no system of internal control. The report contained 5 findings with 24 recommendations. At the time of this review, four recommendations were resolved.

The Single Audit Report of the Puerto Rico Public Housing Administration for the year ended June 30, 2001, was issued on March 15, 2002. The report contained an unqualified opinion on the general-purpose financial statements and a qualified opinion on compliance with requirements applicable to each major program and on internal control over compliance. The report questioned costs totaling $2,065,939. Among the deficiencies reported were: (1) lack of supporting documentation for disbursements, (2) inadequate internal controls over disbursements, (3) commingling of funds, (4) inadequate inventory records, and (5) lack of PRPHA monitoring over procurement procedures generated by management agents. Additionally, the report incorporated the findings included in the agreed-upon procedures reports regarding the review conducted on the operations of the management agents. The reports questioned costs totaling $1,480,124. The total questioned costs for the reports were $3,546,063.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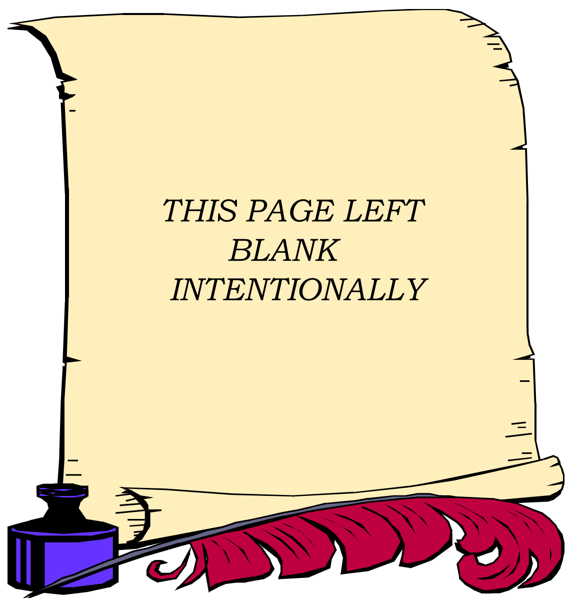
Schedule of Questioned Costs and Funds Put to Better Use

Recommendation Number	Type of Questioned Cost Ineligible 1/	Unsupported 2/	Funds Put to Better Use 3/
1C	$ 2,007,019		
2A			$ 10,824,363
Total	$ 2,007,019		$ 10,824,363

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 costs charged to a HUD-financed or HUD-insured program or activity and eligibility cannot be determined at the time of audit. The costs are not supported by adequate documentation or there is a need for a legal or administrative determination on the eligibility of the costs. Unsupported costs require a future decision by HUD program officials. This decision, in addition to obtaining supporting documentation, might involve a legal interpretation or clarification of Departmental policies and procedures.

3/ Funds Put to Better Use are costs that will not be expended in the future if our recommendations are implemented.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GAR Housing Expenses-Fiscal Year 2000-2001

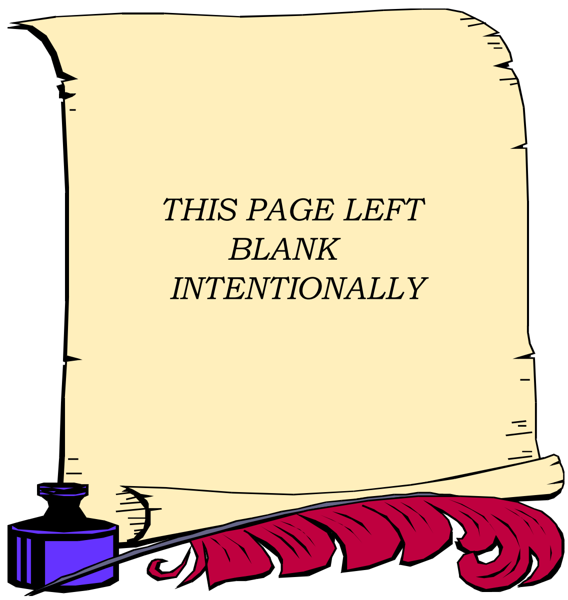
Account	Amount Approved	Amount Incurred	Amount Not Allocable/ Reasonable	Amount Estimated Reasonable Per OIG	Remarks
Non-Project Salaries	$943,153	$862,652	$79,502	$783,150	We considered $79,502 not allocable since it included duplicate costs and excessive salaries.
OVERHEAD					
Rent	61,200	41,543		41,543	
Telephone	15,300	15,382		15,382	
Photocopier	9,180	12,085		12,085	
Cellular Phones	6,120	8,419		8,419	
Beepers	3,570	3,570		3,570	
Office Supplies	6,120	20,178		20,178	
Janitorial services	2,040	2,640	0	2,640	
Medical Plan	20,400	7,026	0	7,026	
Insurance	35,700	51,687	38,075	13,612	We deducted $38,075 for fidelity and performance bonds expenses that were prohibited by the agreement. Amount expended exceeds the amount approved.
Car Allowance	8,160	9,604	7,004	2,600	GAR records reflected expenditures of $9,604 paid to two officials, but were charged to the Ordinary Maintenance account. The costs should have been based on actual costs incurred. We estimated that $2,600 would have been a reasonable amount. We deducted $7,004 for excessive car allowances.
Legal Expense	61,200	1,650		1,650	
Staff Training	51,000	67,216		67,216	
Municipal Taxes	24,786	33,001	18,268	14,733	We deducted $13,285 since it included charges for fines and penalties and $4,983 for taxes on personal property. Amount expended exceeded the amount approved.
Resident Initiatives	385,418	0		0	Although it was approved by the PRPHA, there were no related charges incurred by GAR. Therefore, no amount were allowed. Instead, GAR executed professional service contracts with identity-of-interest entities.
Security	102,000	0		0	
Elevator maintenance	51,000	0		0	
Cistern Maintenance	20,400	0		0	
Emergency Generator	20,400	0		0	
Legal Service	102,000	0		0	
Computer Maintenance	30,600	0		0	
Other overhead expenses claimed, but not approved by the PRPHA					
Professional Services	0	$462,931	$452,644	10,287	GAR records reflected total expenditures of $464,581. We subtracted $1,650 from this account and transferred it to Legal account. The $414,394 related to payments to identity-of-interest entities not authorized by the PRPHA, and $38,250, which was not considered necessary.
Accounting Fee	0	875	0	875	
Audit Fee	0	20,675	0	20,675	
Publications	0	456	0	456	
Membership Dues	0	275	0	275	
Other Sundry	0	39,686	4,542	35,144	GAR records reflected total expenditures of $49,352. We applied $2,640 to the Janitorial Services account, and applied an additional $7,026 to the Medical Plan account. The $4,542 disallowed related to flowers, gifts, food, parties, etc.
Finance Charges	0	1,159	1,159	0	The agent was required to be solvent and should have made the payments from its own funds. In addition, it was not approved by the PRPHA.
Administrative Salaries	0	32,750	32,750	0	The expenditures were for positions not approved by the PRPHA.
Social Security Expense	0	2,257	2,257	0	
Disability & Chauffer	0	25	25	0	
FUTA	0	64	64	0	
SUTA	0	297	297	0	
Rec. Pub. & Other	0	12,761	12,761	0	The charges to this account were mainly for entertainment (Christmas party) that was not allowable.
Ordinary Maint. Mat.	0	1,005	0	1,005	
Property Bett. & Addit.	0	3,475	3,475	0	The expenditures pertained mostly to property acquisition (file cabinets).
Depreciation	0	31,791	0	31,791	
Interest Expense	0	4,858	4,858	0	The costs pertained to interest on a loan for the purchase of computer equipment. The agent was required to be solvent and should have paid the financing costs from its own funds.
Overhead Sub-Total	$1,016,594	$889,341	$578,179	$311,162	
Profit	$391,949	$177,277	$282,518	$109,431	The $282,518 was excessive based on the suggested 10 percent of direct costs.
TOTAL	**$2,351,696**	**$1,929,270**	**$940,199**	**$1,203,743**	The $1,203,743 was a more reasonable fee with a per unit month of $28.

The management agent contracts were awarded based on a fixed fee. For our review, we accepted some costs that exceeded the budget amount or were not budgeted, if we considered the costs allowable or reasonable, since the management agents did not exceed their total approved budget amounts.

Housing Promoters Expenses-Fiscal Year 2000-2001

Account	Amount Approved	Amount Incurred	Amount Not Allocable/ Reasonable	Amount Estimated Reasonable Per OIG	Remarks
NON-PROJECT SALARIES	$1,085,634	$1,063,649	$425,293	$638,356	We considered $425,293 not allocable since salaries charged were excessive, the agent did not prorate the salaries of employees performing tasks not related to the public housing program, it charged fringe benefits of Section 8 employees, and charged mileage rate above the amount allowed by the Federal government.
OVERHEAD					
Rent	$75,872	$100,559	$23,783	$76,776	We deducted $7,302 for rent paid to identity-of-interest firms that exceeded the rates paid by others at the site and $16,481 for rent that should have been allocated to other businesses owned by the agent. Amount expended exceeded approved amount.
Electricity	12,393	11,624	2,221	9,403	We deducted $157 that pertained to Section 8 units managed by the agent. We also deducted $2,064 for costs that should be allocated to other businesses owned by the agent.
Telephone & Radiotelephone & Beeper	35,362	49,223	9,204	40,019	We deducted $419 that pertained to charges of a private residence and $8,785 for costs that should be allocated to other businesses owned by the agent
Travel Expenses	82,484	56,731	41,454	15,277	The costs included $52,500 for car allowances paid to 12 agent officials. The costs should be based on actual costs incurred. Since other employees were paid based on actual costs, we estimated that $14,400 was a reasonable amount. We deducted $38,100 for excessive car allowances and $3,354 for costs allocable to other businesses owned by the agent.
Vehicle Expenses	33,766	7,478	4,622	2,856	We deducted $4,622 since it included charges for traffic violations fines, and payments for repairs to the POV of Maldonado and relatives.
Repair & Maintenance	4,918	13,875	7,808	6,067	We deducted $4,608 for salaries that were improperly classified in the Repair and Maintenance account. We are also deducting $1,868 of costs pertaining to damages caused by Hurricane Georges and $1,332 allocable to other business owned by the agent.
Municipal Taxes	7,107	7,752	747	7,005	We deducted $93 pertaining to Section 8 projects and $654 allocable to other businesses owned by the agent.
Property Taxes	5,043	8,229	1,481	6,748	We deducted $1,481 for the portion allocable to other businesses owned by the agent.
Insurance	64,890	11,301	11,301	0	No costs were allowed since it pertained to workman compensation insurance, which was covered on the fringe benefits billed to the PRPHA under the non-project salaries.
Professional Services	26,564	13,213	0	13,213	
Legal Expense	34,129	15,261	15,037	224	We deducted $15,037 that pertained to a lawsuit when agent was managing another public housing area under a previous contract.
Office Expenses	116,899	119,661	33,429	86,232	We deducted $14,500 for a Christmas party charged to the account. We also excluded $18,929 for expenditures allocable to other businesses owned by the agent.
Hardware & Software Maintenance	5,302	8,997	1,619	7,378	We deducted $1,619 allocable to other businesses owned by the agent.
Personnel Training	17,332	21,916	3,418	18,498	We deducted $2,496 for training not related to the public housing program. We also deducted $745 for the tuition costs paid on behalf of a consultant, who is also the son-in-law of the agent's President and $181 for training expenses of employees working for the Section 8 Projects.
Dues & Subscriptions	881	1,069	0	1,069	
Overhead Sub-Total	$522,942	$446,889	$156,124	$290,765	
Profit	386,505	386,505	293,593	92,912	The $293,593 was excessive based on the suggested 10 percent of direct costs.
TOTAL	**$1,995,081**	**$1,897,043**	**$875,010**	**$1,022,033**	The $1,022,033 was a more reasonable fee with a per unit month of $24.

The management agent contracts were awarded based on a fixed fee. For our review, we accepted some costs that exceeded the budget amount or were not budgeted, if we considered the costs allowable or reasonable, since the management agents did not exceed their total approved budget amounts.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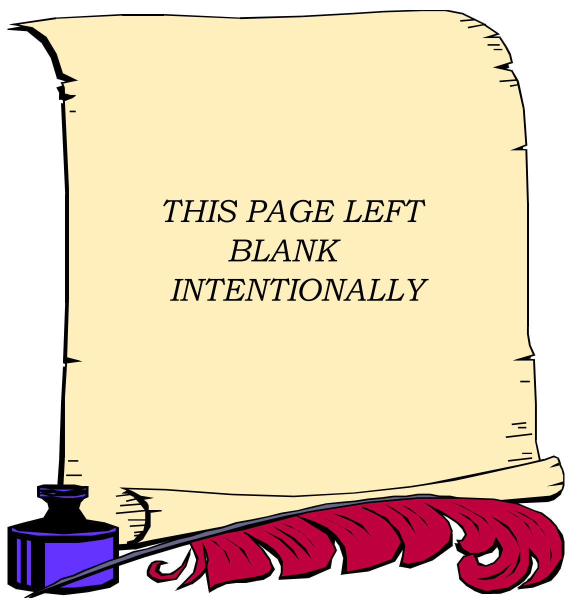
Westbrook Management Expenses-
Fiscal Year 2000-2001

Account	Amount Approved	Amount Incurred	Amount Not Allocable/ Reasonable	Amount Estimated Reasonable Per OIG	Remarks
NON-PROJECT SALARIES	$917,923	$879,522	$42,969	$836,553	We considered $42,969 not allocable since it included an $18,919 bonus to the general manager and excessive car allowance of $24,050
OVERHEAD					
Office Rent	$49,378	$23,813	$3,057	$20,756	We deducted $3,057 which included: 1) $889 for rent of public storage charged twice 2) $20 refundable security deposit, which was not an expenditure, 3) $450 rent for a facility to have a Christmas party for resident councils, and 4) $1,698 estimated excessive office rent paid.
Utilities	23,113	32,445	1,157	31,288	We deducted $1,157, which included a $500 electricity security deposit that was prepaid and reimbursable; and $657 paid to the building owner as a reimbursement for an electricity bill previously paid by the owner on behalf of the agent, but was not supported. Expenditures exceeded approved amount.
Advertising	2,521	460	460	0	We deducted $460 that pertained to a payment to a radio station that was not supported. Therefore, we could not determine the service provided.
Executive Salaries & Benefits	232,183	300,000	300,000	0	Expenditures exceeded the approved amount. We deducted the $300,000, since the salaries were to executive officials of the parent company (identity-of-interest). In addition, the parent company was the profit for the management contract ($190,222 for FY 2000-2001 and $995,040 for the whole management contract). Finally, the agent did not obtain prior approval from the PRPHA to contract with identity-of-interest, Burke Properties, as required by the agreement.
Accounting- Audit	0	55,400	2,700	52,700	We deducted 2,700 that was a duplicate charge.
Legal	0	17,226	0	17,226	The PHA did not approve this account. Although the agent did not provide a contract for the legal services, the services were considered allocable.
Consultants	63,036	33,230	0	33,230	The review of charges disclosed that $33,230 was allowable & allocable.
Office Supplies	22,063	21,302	0	21,302	The review of charges disclosed that $21,302 was allowable office expenses.
Donations	16,810	2,283	2,283	0	We deducted the whole amount since it is not an allowable cost.
Insurance	34,145	71,384	38,466	32,918	We deducted $36,387 because the agent did not provide enough supporting documents to determine if the insurance was allowable and allocable. We also deducted $2,079 in accrued charges that pertained to insurance after June 2001, which was after the budget period and not allocable. Expenditures exceeded the approved amount.
Repairs & Maintenance	2,225	19,919	0	19,919	The account included $2,708, although allowable, it was erroneously classified as repair and maintenance, but it pertained to services for installation of computer software and office supplies. Expenditures exceeded the approved amount.
Travel	89,826	24,553	7,546	17,007	We deducted $7,546 that pertained to charges such as duplicate lodging, food, limousine services, car leases, and car repairs for staff that had car allowances.
Property & License Taxes	16,284	4,388	0	4,388	
Representation	32,569	13,701	13,149	552	We deducted $13,149 since it included ineligible items (liquor bottles, flower & basket arrangements) and other items that did not appear to be reasonable (dinner-$1,118). It also included a duplicate payment of $50.
Activities	15,759	27,881	13,150	14,731	We deducted $13,150, which included costs for the agent's Christmas activity, involving alcoholic beverages, political contributions, gifts, other entertainment expenses, and duplicate costs. We also deducted expenses that were not supported. Expenditures exceeded the approved amount.
Miscellaneous	7,336	7,426	574	6,852	We deducted payment of $278 to the general manager, for reimbursement of repairs to a vehicle that was vandalized. We also deducted $296 that the agent could not support. Expenditures exceeded the approved amount.
Depreciation	27,316	19,872	0	19,872	
Overhead Sub-Total	$634,563	$675,283	$382,542	$292,741	
Profit	190,222	190,222	77,293	112,929	The $77,293 was excessive based on the suggested 10 percent of direct costs.
TOTAL	**$1,742,708**	**$1,745,027**	**$502,804**	**$1,242,223**	The $1,242,223 was a more reasonable fee with a per unit month of $27.

The management agent contracts were awarded based on a fixed fee. For our review, we accepted some costs that exceeded the budget amount or were not budgeted, if we considered the costs allowable or reasonable, since the management agents did not exceed their total approved budget amounts.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Auditee Comments

PUERTO RICO PUBLIC HOUSING ADMINISTRATION

Carlos G. Laboy-Díaz
Administrator

DEPARTMENT OF HOUSING
COMMONWEALTH OF PUERTO RICO
PUBLIC HOUSING ADMINISTRATION

February 27, 2003

Ms. Nancy H. Cooper
Regional Inspector General For Audit
US. Department of Housing and Urban Development
Region 4 Office of the Inspector General
Office of Audit
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, GA 30303-3388

RE: Procurement of Management Agents
Puerto Rico Public Housing Administration

Dear Ms. Cooper:

On behalf of the Puerto Rico Public Housing Administration (PRPHA), thank you for the opportunity to submit comments on the above-referenced draft audit report. The audit performed by the Office of the Inspector General (OIG) reviewed the procurement process that led to the execution of the Public Housing Management Agents Service Contract with the fifteen (15) Management Agents, which were originally contracted pursuant to RFP-98-99-04. This audit concluded that the former PRPHA officials involved in the procurement process failed to discharge their duties. It further concluded that, due to the flawed procurement process, the PRPHA is incurring in unreasonable costs that are being charged by the Management Agents. Finally, the report stated that the three Management Agents that were examined as part of the audit charged PRPHA for unallowable expenses

The OIG draft Audit Report on the Procurement of Management Agents (RFP-98-99-04) reinforces PRPHA's own analysis of the Public Housing Management Agents Service Contract it currently has in effect. In commenting, PRPHA will focus on OIG's recommendations (Part I, below), although it will comment on certain statements in the draft Audit Report (Part II, below).

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Ms. Nancy H. Cooper
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Part I

Recommendation 1.A. Identify the PRPHA officials responsible for the gross mismanagement of the management agent procurement process and take administrative action as contained in 24 CFR § 85.43.

PRPHA joins with the OIG to urge HUD to take appropriate action against all PRPHA or HUD officials, past or current, whose conduct violated or permitted the violation of applicable regulations and the sound administration of federal funds. Further, PRPHA offers its cooperation in any investigation that HUD or the OIG or any other federal or state agency may undertake in this matter. When requested, the PRPHA will submit any and all information it has regarding any PRPHA official involved in the procurement process that was the subject of this audit.

Recommendation 1. B. Require the PRPHA to deduct $2,007,019 from GAR's invoices to correct the operating costs improperly included in the proposal and contract award and reimburse the funds to HUD.

The PRPHA has sent a demand letter to GAR Housing Corporation (GAR) for the amount of $1,909,510. This amount was determined following an agreed-upon-procedures report performed by the CPA firm Nieves Velázquez & Co., PSC at PRPHA's request and differs slightly from OIG's estimate.

In addition, the PRPHA has determined that GAR's violations of its contractual obligations and performance warrants a termination of the contract for cause. To do so, we have requested HUD's concurrence for such termination.

The PRPHA requests from the OIG any and all assistance it can provide in order to recover this $1,909,510. Accordingly, PRPHA requests that OIG provide the documentation it has concerning GAR's debt to the PRPHA and that it commit to providing assistance and advice to PRPHA in pursuit of this claim.

PRPHA does not agree that the monies collected should be reimbursed to HUD. The funds expended on the contract with GAR are federal funds allocated by HUD to the PRPHA as part of its operating subsidy. Therefore, any money collected should be vested in the PRPHA and used for the Puerto Rico Public Housing Program to make it whole.

Recommendation 2. A. Work with the PRPHA to remedy the deficiencies in the contract, or require the PRPHA to pursue all available options provided by the agents' service contracts to ensure the best interests of the PRPHA and HUD are being served, and possibly save $10,824,363 of costs not incurred.

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February 27, 2003
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PRPHA has already started its efforts to remedy the deficiencies in those contracts and will pursue all available options to ensure that its best interests and those of HUD are being served. On October 9, 2001 the PRPHA sent letters to the Management Agents indicating that they needed to support their Management Fee invoices. Since then, the PRPHA has reduced the amount requested by Management Fee invoices by approximately $1.1 million for disallowed costs. The request has also resulted in additional savings in an amount of approximately $860,000, because some Management Agents have not incurred overhead costs equal to the amount that had been budgeted for them.

The PRPHA is now negotiating amendments to the contracts with the Management Agents with the principal objectives of reducing the per unit management fees and basing compensation on a per-occupied-units fee. These changes will reduce the overall costs of the contracts significantly. If the Management Agents are not willing to negotiate, the PRPHA will seek HUD's concurrence to cancel the corresponding contract for convenience.

Furthermore, the PRPHA has also filed a Declaratory Judgment action against the fourteen (14) Management Agents. This action seeks a determination that the contracts are reimbursement based, that the PRPHA is entitled to request and obtain from the Management Agent documented invoices of reasonable, eligible, legal and otherwise allowable overhead expenses before disbursing funds, and that it can disallow improperly charged expenses. If the determination of the Court is as the PRPHA expects, the PRPHA will contract with CPA firms to perform a forensic audit of the Management Agent management Fee expenses.

Finally, it should be noted that as soon as Mr. Edwin R. Cornier, the President of ERCO Enterprises (one of the original fifteen (15) Management Agents) was indicted, the PRPHA immediately cancelled ERCO's contract to manage the projects in Area XI (the easternmost part of the Island). As a result, PRPHA has saved approximately $5 million. Thus the total savings obtained from the actions taken to date has been approximately $7 million as of December 31, 2002.

As noted above, the PRPHA is moving aggressively to achieve further cost savings from these contracts.

Recommendations 3.A and 4.A. See recommendation 1A.

Since these merely refer to Recommendation 1.A., they have been dealt with above.

Part II

Although we have focused on the recommendations, there are several items in the body of the draft report that merit comment. The first is the section on "Management Controls" at pp 29-30. That section identifies a number of significant weaknesses concerning the procurement of the management agents' contracts. We believe that these refer to the actions of the former Administration of PRPHA, but suggest that this be clarified. Under the current Administration,

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PRPHA has improved its procurement processes and its management controls. These improvements have been possible, in part, due to HUD's technical assistance in the procurement area. We believe that, by and large, procurement deficiencies have been corrected so that the PRPHA procurement process is no longer subject to significant weaknesses. It would also be appropriate to reflect this in the final report.

The draft report variously refers to one of the management agents, which has since been terminated, being indicted for "excess charges" and "on fraud". It is our understanding that the President of this agent was indicted for, inter alia, bribing a HUD official, but not for "excess charges". The language in the final report should correctly state the charges against Mr. Edwin R. Cornier.

The draft report refers, in at least two instances, to the "failed" procurement process of the management agents. This should be corrected since the procurement did not "failed" but was "flawed".

Finally, the draft Report is silent on HUD's performance or lack of performance in connection with the subject procurement and contract administration, although it certainly presents a major issue. Nor does the draft Report recognize the dramatic changes in HUD's Caribbean Office over the last two years – changes that have vastly improved the office's oversight of public housing within its jurisdiction. These points should be recognized in the final Audit Report.

We hope that you find these comments useful as you finalize your report. If you have any questions or want to further discuss this matter with me, do not hesitate to call me at 787-274-2646.

Sincerely,

Carlos G. Laboy-Díaz

cc: Hon. Ileana Echegoyen-Santalla
Secretary
Commonwealth of Puerto Rico Department of Housing

Mr. Erótido Rivera
Director, Office of Public Housing
Caribbean Hub Office

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