AUDIT REPORT

PUERTO RICO DEPARTMENT OF HOUSING

STATE HOME INVESTMENT PARTNERSHIP PROGRAM

SAN JUAN, PUERTO RICO

2003-AT-1006

JULY 30, 2003

OFFICE OF AUDIT, REGION 4
ATLANTA, GEORGIA

Issue Date	Audit Case Number
July 30, 2003	2003-AT-1006

TO: Carmen R. Cabrera, Director, Community Planning and Development, 4ND

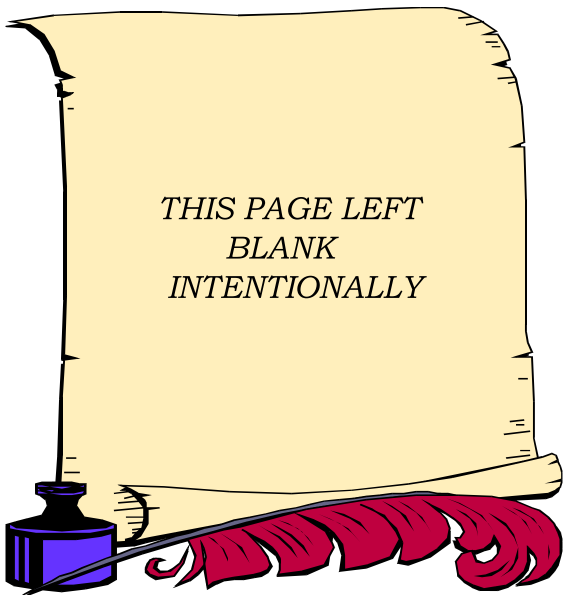
FROM: Nancy H. Cooper
Regional Inspector General for Audit, 4AGA

SUBJECT: Puerto Rico Department of Housing
State HOME Investment Partnership Program
San Juan, Puerto Rico

We completed a review of the Puerto Rico Department of Housing's (Department) State HOME Investment Partnership Program activities. The review was initiated in response to a request from the Department of Housing and Urban Development's (HUD) Caribbean Office of Community Planning and Development, regarding the results of its August 31, 2001, monitoring report covering a sample of activities funded from 1992 to 2000. Our objectives were to assess the Department's progress in correcting the deficiencies identified in HUD's monitoring report, and review selected projects from the HOME Program New Construction/Rehabilitation for Homeownership Activity to determine if they were carried out in accordance with program requirements. Our report includes two findings.

In accordance with HUD Handbook 2000.06 REV-3, within 60 days, please provide us, for each recommendation without a management decision, 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 Department of Housing's State HOME Investment Partnership Program. We began the review in response to a request from HUD's Caribbean Office of Community Planning and Development, regarding the results of its August 31, 2001, monitoring report covering a sample of activities funded from 1992 to 2000. Our objectives were to assess the Department's progress in correcting the deficiencies identified in HUD's monitoring report, and review selected projects from the HOME Program New Construction/Rehabilitation for Homeownership Activity to determine if they were carried out in accordance with program requirements.

Our assessment showed that the Department did not have an adequate financial management system, and did not accomplish its intent for two of its new housing development/rehabilitation for homeownership projects.

Our review disclosed

The Puerto Rico Department of Housing's HOME grants were unauditable. This condition existed because the Department had an inadequate accounting system that did not properly account for or report on program activities. Records and reports were not accurate, current, or complete. These deficiencies were identified in prior Independent Public Accountant reports and HUD monitoring reviews; yet, the deficiencies continued to exist. The Department had not provided sufficient staff and training to correct the problems and disregarded program requirements. As a result, HUD has no basis for reliance on reports submitted by the Department on its HOME Program activities. In addition, the Department incurred ineligible program costs of $29,313.

The Puerto Rico Department of Housing's New Housing Development for Homeownership Projects HOME Program has not accomplished its intent for two of three projects reviewed. The HOME funds were spent for work not performed or that was incomplete, and for excessive costs. The Department spent HOME funds on a housing development project that was constructed in a flood zone. Further, the Department has experienced slow progress in completing two of the three housing development projects reviewed. This occurred because the Department disregarded program requirements and had inadequate management controls. As a result, HOME Program funds totaling $1,658,171 were ineligible, $627,015 were unsupported, and if the Department does not take corrective action an additional $1,029,814 could be misspent.

Recommendations

We recommend that you suspend disbursements of any further HOME awards until the Department can demonstrate accountability and compliance for all HOME grants. We also recommend that you require the Department to reimburse HUD ineligible costs of $1,687,484, determine the eligibility of $627,015 in unsupported costs, and determine the status of the projects and possibly save $1,029,814.

We presented our results to the Department and HUD officials during the audit. We provided a copy of the draft report to the Puerto Rico Housing Department and HUD's Caribbean Office on May 30, 2003, for their comments. We discussed the report with the officials at the exit conference on June 16, 2003. The Department provided written comments on July 11, 2003. The Department officials generally agreed with the findings and recommendations. The Department's comments are summarized in the findings and included in their entirety as Appendix B. The Department provided exhibits with the comments, which are available upon request.

Table of Contents

Abbreviations

CFR	Code of Federal Regulations
HUD	U. S. Department of Housing and Urban Development
HOME	HOME Investment Partnership Program
IDIS	Integrated Disbursement and Information System

Introduction

The HOME Investment Partnership Program was created under Title II of the Cranston-Gonzalez National Affordable Housing Act, as amended. HOME was designed to strengthen public-private partnerships to expand the supply of decent, safe, sanitary, and affordable housing to low and very low-income families.

In 1972, the government of Puerto Rico established the Department of Housing (Law 97 dated June 10, 1972). The Puerto Rico Department of Housing operates through a Secretary appointed by the Governor of the Commonwealth of Puerto Rico to implement the governmental policy related to low-income housing. The primary sources of funds to carry out the Government's low-income housing programs are Federal Government subsidies and grants.

On February 10, 1992, HUD designated the Commonwealth of Puerto Rico eligible under Title 24 of the Code of Federal Regulations (CFR) 92.102 through 92.104 of the Interim Rule to participate in the State HOME Investment Partnership Program. The Department is the Commonwealth of Puerto Rico's designated agency for the administration of the State HOME Program. The Department's Planning and Technical Services Division had the responsibility to administer the State HOME Program until September 2002. The HOME Program activities consisted of Construction/Rehabilitation for Homeownership, Construction/Rehabilitation for Rent, Construction/Rehabilitation by Owners, and Community Housing Development Organizations, as well as program administration. On June 30, 2002, the administration of the Homeownership Activity was transferred to the Housing Development and Improvement Administration, an organization within the Department. Subsequently, in September 2002, the administration of the remaining HOME activities was also transferred to the Housing Development and Improvement Administration.

In April 2001, HUD initiated a review of the State HOME Program administered by the Puerto Rico Department of Housing. HUD concluded that the Department did not manage its HOME Program in an effective and efficient manner. The Department disregarded program requirements, it did not establish adequate controls to ensure compliance with applicable requirements, and the Department's financial management system was unacceptable. The report dated August 31, 2001, disallowed $2,030,000 and questioned another $11,101,072 as follows:

Finding	Amount Disallowed	Amount Questioned
Finding #1-Grant Administration/Financial Management		
Finding #2-Administrative Costs		$ 505,000
Finding #3-Subsidy Layering		
Finding #4-Property Standards		
Finding #5-Rehabilitation		371,164
Finding #6-Acquisition	$ 2,000,000	
Finding #7-Rental Housing	30,000	
Finding #8-Subdivision Housing Development		9,590,108
Finding #9-Procurement		634,800
Finding #10-Monitoring/All Activities		
Total	$ 2,030,000	$11,101,072

The Puerto Rico Department of Housing received $127,120,000 in HOME grant funds for fiscal years 1992 to 2002. For fiscal year 2003, the Commonwealth of Puerto Rico was expected to receive $18,296,000 for its HOME Program. The Department's books and records are maintained at 606 Barbosa Avenue, San Juan, Puerto Rico. HUD's Caribbean Office of Community Planning and Development in San Juan, Puerto Rico, is responsible for overseeing the Department's administration of the program.

Audit Objectives, Audit Scope and Methodology

Our objectives were to assess the Department's progress in correcting the deficiencies identified in HUD's monitoring report, and review selected projects from the HOME Program New Construction/Rehabilitation for Homeownership Activity to determine if they were carried out in accordance with program requirements.

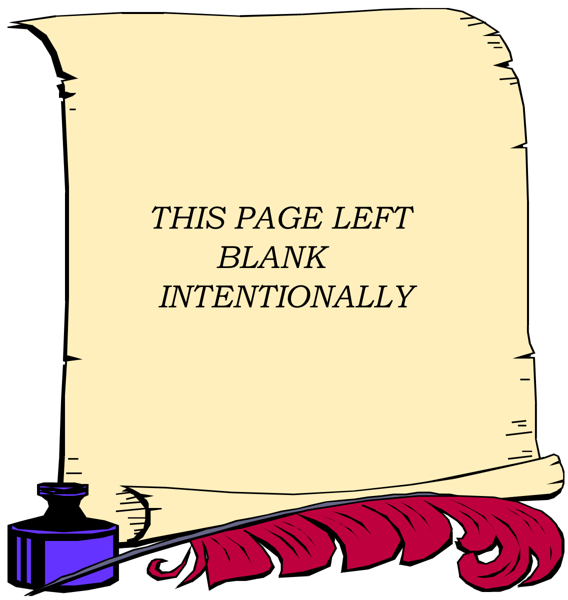
To accomplish the objectives, we reviewed applicable laws, regulations, and other related requirements and tested program activities for compliance. We evaluated the Department's New Construction/Rehabilitation for Homeownership Activity project selections, construction and disbursement procedures, and assessed the Department's improvements to its financial management system. We reviewed related Puerto Rico Department of Housing, HUD, and project developers' files and records, HUD's August 2001 monitoring report, and reports from the Independent Public Accountants. We also interviewed responsible Caribbean Office Community Planning and Development program officials, Department staff, and project developers.

We reviewed project records and conducted site inspections for 3 of the 35 New Construction/Rehabilitation for Homeownership projects. The project records were reviewed and inspections were performed to determine compliance with the HOME Program requirements and to assess the progress of the HOME funded activities. The projects selected were Paseo Horizonte II, Salinas, Puerto Rico; Vilar Development, Barceloneta, Puerto Rico; and Estancias de San German, San German, Puerto Rico. We selected two projects that reflected slow progress and/or construction was suspended, and one project in which the developer had related ownership interest and the most recent disbursements. The three projects represented

$4,415,000 of over $43 million of HOME funds assigned to the 35 projects.

We tested the Department's financial management system in use for the HOME Program in February 2003 and we selected and tested administrative expenditures from June 2000 through September 2002 to assess the progress in correcting the financial management system and eligibility of the administrative charges to the program. We tested $152,512 in expenditures from the $2.47 million disbursed during the period. Since the financial records were unauditable, alternative testing methods were used to verify the accuracy of questioned HOME Program expenditures. We selected these expenditures from the check register by type of vendor, purpose of payment, and knowledge obtained while auditing other areas of the program. 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, 2001, through June 30, 2002, which represented $15,061,000 in HOME grant funds awarded. We extended the periods as necessary. We performed our on-site work between July 2002 and February 2003. We provided a copy of our report to the Honorable Ileana Echegoyen, Secretary, Puerto Rico Department of Housing. We conducted our review in accordance with generally accepted government auditing standards.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The HOME Program Grants Were Unauditable

The Puerto Rico Department of Housing's HOME grants were unauditable. This condition existed because the Department had an inadequate accounting system that did not properly account for or report on program activities. Records and reports were not accurate, current, or complete. These deficiencies were identified in prior Independent Public Accountant reports and HUD monitoring reviews; yet, the deficiencies continued to exist. The Department had not provided sufficient staff and training to correct the problems and disregarded program requirements. As a result, HUD has no basis for reliance on reports submitted by the Department on its HOME Program activities. In addition, the Department incurred ineligible program costs of $29,313.

Title 24 CFR, Part 85.20(a) requires that States, as well as its subgrantees and cost-type contractors, must maintain fiscal control and accounting procedures sufficient to permit: (1) preparation of reports required by this part and the statutes authorizing the grant, and (2) the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Title 24 CFR, Part 92.508(a) requires that each participating jurisdiction must establish and maintain sufficient records to enable HUD to determine whether the participating jurisdiction has met the requirements of the Program. Section (a)(5) requires that the participating jurisdiction must maintain records: (1) identifying the source and application of funds for each fiscal year, including the formula allocation, and any reallocation identified by federal fiscal year appropriation; (2) concerning the HOME Investment Trust Fund Treasury account and local account; (3) identifying the source and application of program income, repayments, and recaptured funds; and, (4) demonstrating adequate budget control, in accordance with 24 CFR 85.20, including evidence of periodic account reconciliations.

Title 24 CFR Part 92.207 lists what reasonable administrative and planning costs should include. Subsection 92.207(a) indicates that costs of overall program management, coordination, monitoring, and evaluation are reasonable administrative costs.

Title 24 CFR, Part 92.551(c) provides that HUD can impose on the Department corrective and remedial actions for failure to comply with any provision of the HOME Program. Corrective or remedial actions for a performance deficiency will be designed to prevent a continuation of the deficiency; mitigate, to the extent possible, its adverse effects or consequences; and prevent its recurrence. HUD may instruct the participating jurisdiction to submit and comply with proposals for action to correct, mitigate and prevent a performance deficiency, including: (1) preparing and following a schedule of actions for carrying out the affected activities, consisting of schedules, timetables, and milestones necessary to implement the affected activities; (2) establishing and following a management plan that assigns responsibilities for carrying out the remedial actions; (3) canceling or revising activities likely to be affected by the performance deficiency, before expending HOME funds for the activities; (4) reprogramming HOME funds that have not yet been expended from affected activities to other eligible activities; (5) reimbursing its HOME Investment Trust Fund in any amount not used in accordance with the requirements of this part; (6) suspending disbursement of HOME funds for affected activities; and (7) making matching contributions as draws are made from the participating jurisdiction's HOME Investment Trust Fund United States Treasury Account. HUD may also change the method of payment from an advance to reimbursement basis; and take other remedies that may be legally available.

Background

Prior Independent Public Accountant reports and HUD monitoring reviews reflected deficiencies related to the Department's financial management system; however, the Department did not correct the problems. For example, the Independent Public Accountant report for fiscal year ended June 30, 2001, stated that the Department had not established adequate financial management controls and accounting procedures to carry out proper cash management over federal funds. A HUD review conducted between April and June 2001 concluded that the Department did not manage its HOME Program in an effective and efficient manner. The Department disregarded program requirements and did not establish adequate controls to ensure compliance with applicable requirements. Among the deficiencies reported, was that the Department's financial management system was unacceptable. The report dated August 31, 2001, stated:

- The Department had not established a financial management system.
- It had not established procedures to adequately account for program funds and program income.
- It used excel spreadsheets to record disbursements.
- Actual expenditures were not reconciled with budgeted amounts for each grant.
- The financial information included in the Integrated Disbursement and Information System (IDIS) was inaccurate.

The monitoring report advised that if corrective actions for the financial system were not in place within 60 days, HUD could consider imposing sanctions pursuant to 24 CFR 92.552. HUD granted several time extensions, as requested by the Department, to complete its responses to the monitoring review as shown in the following table:

Time Extension Requested	**Date HUD Approved Time Extension**	**Time Extension Approved by HUD**	**New Due Date for Responses**
30 days	October 1, 2001	30 days	October 30, 2001
60 days	February 2, 2002	60 days	March 31, 2002
60 days	April 18, 2002	60 days	June 10, 2002
180 days	July 16, 2002	15 days to correct the financial management system. 180 days for all other HOME Program & CHDO activity open findings.	July 31, 2002 December 10, 2002

As indicated in the above table, HUD gave the Department until the end of July 2002 to correct its financial management deficiencies. Almost 2 years have elapsed since HUD initially detected the deficient conditions, and the Department has not demonstrated compliance with requirements for its financial management system. The same conditions reported in 2001 still exist in 2003.

HUD officials stated that they approved the extensions because they wanted to give the Department all opportunities to correct the deficiencies reported in the monitoring review. In addition, the officials stated that if the Department did not implement an acceptable financial management system by June 30, 2003, its fiscal year 2003 HOME grant might not be approved.

Accounting system remained inadequate

In a letter dated July 24, 2002, the Puerto Rico Department of Housing's Assistant Secretary for Finance and Information Systems informed HUD that they had established a financial management system to comply with the regulatory requirements. He also stated that they successfully implemented the mechanized accounting system, known as "Emphasys," to record all transactions during fiscal year ended June 30, 2002, and reconciled all the funds for prior fiscal years.

However, as of February 2003, we concluded that the improvements to the accounting system were not adequate. The Department's mechanized accounting system was flawed. It did not: (1) identify expenditures by Federal fiscal year appropriation; (2) reflect program expenditures prior to fiscal year 2002; or, (3) demonstrate adequate budgets control; as required. Therefore, approved amounts and expenditures reported in HUD's IDIS could not be traced to the accounting records maintained.

Data that was recorded in the Department's accounting system was not accurate or current. Expense accounts had negative balances and transactions were posted to incorrect accounts. For example, the June 2002 trial balance for administrative accounts reflected a negative balance of $443,192. Prior to July 2001, the general ledger did not contain project expenditures by program year. When the Department established its accounts in the Emphasys accounting system, they entered the balances of obligated amounts for projects prior to July 2001, and did not identify the projects by program years or record the amounts expended during the prior years. We also determined that the Department was not timely posting accounting transactions. In February 2003, the Finance Director acknowledged the lag and stated that transactions were posted up to August 2002, which was still 6 months behind.

The Department would not commit adequate staffing to correct the deficiencies in its financial management system. The Assistant Secretary for Finance and Information System stated that if staff was utilized to correct and keep the system updated, other areas would suffer. He explained that a Certified Public Accountant firm was contracted to reconcile all HOME disbursements from program years 1992 through 2000. To incorporate the reconciliation performed by the Certified Public Accountant would divert existing personnel to do the work, adversely affecting the daily operations of his department. Accordingly, he decided not to continue the reconciliation and/or updating the financial management system.

HUD's Integrated Disbursement and Information System reflected program income receipts of $827,539 and program income net disbursements of $747,318 as follow:

IDIS-C04PR27

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF COMMUNITY PLANNING AND DEVELOPMENT
INTEGRATED DISBURSEMENT AND INFORMATION SYSTEM
STATUS OF HOME GRANTS FOR
PUERTO RICO MXXSG720100

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-------- PROGRAM INCOME (PI) --------

FISCAL YEAR	PROGRAM INCOME RECEIPTS	AMOUNT COMMITTED TO ACTIVITIES	% CMTD	NET DISBURSED	DISBURSED PENDING APPROVAL	TOTAL DISBURSED	% DISB
2000	$ 802,605.53	$ 775,441.29	96.6	$747,318.35	$ 21,279.00	$768,597.35	95.7
2001	11,537.80	0	0	0	0	0	0
2002	13,396.50	0	0	0	0	0	0
TOTAL	$ 827,539.83	$ 775,441.29	93.7	$747,318.35	$ 21,279.00	$768,597.35	2.5

The Department's accounting system did not reflect any of the program income reported in IDIS as required. The Director of the Department's Federal Finance Office stated that they have not accounted for the program income in the Emphasys financial management system.

Our review of the HOME Program records disclosed the amount reported as program income in IDIS was overstated by at least $620,687 and the correct amount should be $206,852. In addition, $340,280 of recaptured funds was not included in IDIS. Since the Department did not maintain an adequate financial management system, and due to the conditions of its records, we could not verify the information in IDIS.

Expenditures not allocable

Our examination of administrative disbursements totaling $152,512 for fiscal year 2002, disclosed over $29,300 in expenditures that were not allocable to the HOME Program as follow:

- Professional Services The Department contracted with two consultants to advise them on urban studies and provide general assistance to the Planning and Technical Services division. Examination of the invoices revealed that some of the tasks charged by the consultant were not related to the HOME Program. Examples of the questioned charges included: (a) review of drawings related to renovation of the main facilities of the Puerto Rico Housing Department and Puerto Rico Public Housing Administration, (b) relocation of Section 8 regional offices, (c) review of Section 8 program budget, (d) preparation drawings for the offices of the Secretary of the Puerto Rico Housing Department, and (e) meetings with Section 8 employees. We estimated that at least $22,930 in expenditures was not allocable. The costs were charged as administrative expenditures of the HOME Program.

Vendor	Period	Amount	Not Allocable
Hector Barriera	April 2001	$5,000	$ 1,500
Hector Barriera	May 2001	5,000	4,167
Hector Barriera	June 2001	5,000	2,000
Hector Barriera	July 2001	5,000	2,809
Hector Barriera	August 2001	5,000	4,334
Hector Barriera	October 2001	5,000	2,000
Edwin Lozada	July-August 2001	3,960	2,952
Edwin Lozada	August-September 2001	3,780	3,168
Total		$37,740	$22,930

- College Tuition The Department paid $6,383 in college tuition for its employees and charged it as administrative costs of the HOME Program. The courses charged to the HOME Program appeared to be towards acquiring a college degree. The courses included (a) immunology laboratory, (b) social sciences, (c) marketing principles, (d) humanities, (e) economics, and (f) statistics. These expenditures were not related to the HOME Program.

The costs were not related to the general management or oversight and coordination of the HOME Program, and are contrary to provisions of 24 CFR 92.207. Therefore, the $29,313 charged to the HOME Program was ineligible.

Overall, the Department's HOME Program was unauditable and its financial management system did not ensure economy or efficiency of funded activities. The Department expended $29,313 in HOME funds for activities that were not allocable. The Department officials acknowledged the deficiencies in its financial management system and claimed that these were attributed to the lack of time and trained staff. Since the Department did not have sufficient staff to reconcile the projects' encumbrances and expenses from 1992 through 2000, the information in the Emphasys system was incomplete. Therefore, the disbursement information shown in IDIS did not agree with the Department's accounting records. Despite the fact that HUD provided technical assistance, the Department still has not established written guidelines and procedures for its program management or the financial management system. These deficiencies will continue to occur unless decisive corrective measures are applied.

Auditee Comments

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

"…There is no need to suspend disbursements of HOME funds for any further awards because the Department has reconciled or is reconciling all previous years' grants and has thus demonstrated accountability and compliance for its HOME grants.

"The Department has reconciled the grant years 2001 through 2003, and this was accepted by HUD's Caribbean Office. The contracted CPAs are actually working on reconciling years 1992-2000 to meet the completion deadline of September 30 established by HUD. It is anticipated that this deadline will be met.

"The HOME Program Director has reviewed the courses taken and the job descriptions of the employees. As a result of this analysis, the Program Director has determined that $3,319.00 used to pay employees' college courses was directly related to their responsibilities….

"…It has been determined that $3,064.00 expended in tuition was not in accordance with Administrative Order 98-46 and will be repaid to the HOME Investment Trust Fund.

"Additionally, the OIG audit determined that professional services were charged to the [H]ome Program that were not for services rendered on behalf of the HOME Program. The Planning and Technical Division of the Puerto Rico Department of Housing was in charge of the Section 8 and HOME [P]rograms. As a result of the organization of the office, and the corresponding overlap of some duties and responsibilities, the Department believes that many of the tasks identified were properly attributed to the HOME Program. However, the Department acknowledges that there were some tasks that were not related to the HOME Program, and therefore is preparing a pro rata allocation of costs. The costs determined to be non-related to the HOME Program will be reimbursed to the Program by the Department.

"…The Department agrees to have an annual independent audit performed until all grants are properly accounted for or recovered."

OIG Evaluation of Auditee Comments

The HUD Caribbean Office accepted the Certified Public Accountant's certification that the Department's HOME Program Management Accounting and Reporting Tool was established and implemented in accordance with 24 CFR 85.20. However, all grants from 1992 to date must be properly accounted for in the new system by September 30, 2003. We acknowledge the Department's actions toward compliance. However, we believe the

HOME funds should be suspended until compliance of all HOME grants.

The college tuition was paid for employees pursuing college degrees and not for courses directly related to their responsibilities. Therefore, the $3,319 charged to the HOME Program remains ineligible.

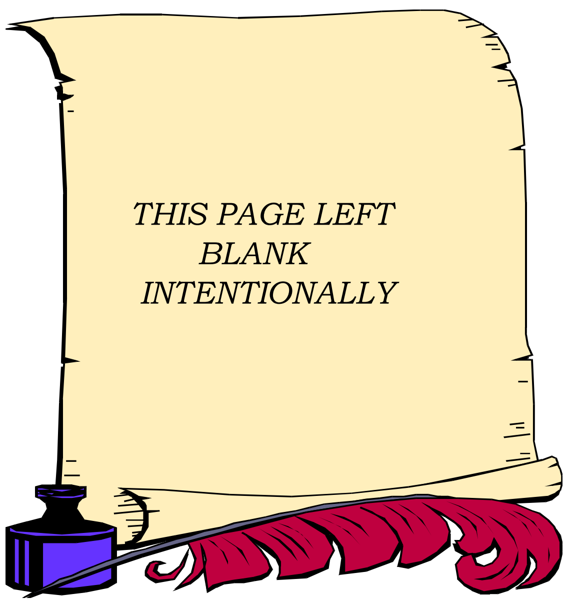
Recommendations

We recommend

1A. Suspend disbursements of HOME funds for any further HOME awards, pursuant to Title 24 CFR 92.551, until it can demonstrate accountability and compliance for all HOME grants.

1B. Recover ineligible costs identified in HUD's monitoring report and reimburse the Department's HOME Investment Trust Fund the $29,313 identified in this report, pursuant to Title 24 CFR 92.551.

1C. Require an independent audit, paid for by the Department, of the HOME Program annually until all grants are properly accounted for or recovered.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The New Housing Development/Rehabilitation For Homeownership Activity Did Not Accomplish Its Intent For Two Projects Reviewed

The Puerto Rico Department of Housing's New Housing Development for Homeownership Projects HOME Program has not accomplished its intent for two of three projects reviewed. The HOME funds were spent for work not performed or that was incomplete, and for excessive costs. The Department spent HOME funds on a housing development project that was constructed in a flood zone. Further, the Department has experienced slow progress in completing two of the three housing development projects reviewed. This occurred because the Department disregarded program requirements and had inadequate management controls. As a result, HOME Program funds totaling $1,658,171 were ineligible, $627,015 were unsupported, and if the Department does not take corrective action an additional $1,029,814 could be misspent.

Criteria

Title 24 CFR 92.504(a) establishes that the participating jurisdiction is responsible for managing the day-to-day operations of its HOME Program, ensuring that HOME funds are used in accordance with all program requirements and written agreements, and taking appropriate action when performance problems arise. The use of State recipients, subrecipients, or contractors does not relieve the participating jurisdiction of this responsibility.

Title 24 CFR 92.250(b) requires before committing funds to a project, the Department must evaluate the project in accordance with guidelines that it has adopted for this purpose and will not invest any more HOME funds, in combination with other governmental assistance, than is necessary to provide affordable housing.

Title 24 CFR 92.205(d) provides that for multi-unit housing projects containing non-HOME assisted units, the HOME Program limits the amount of assistance only to the actual HOME eligible development costs of the assisted units. Section (e) requires that a HOME assisted project that is terminated before completion, either voluntarily or otherwise, constitutes an ineligible activity and any HOME funds invested in the project must be repaid to the Department's HOME Investment Trust Fund.

Title 24 CFR 92.251(a)(1) provides that housing that is constructed or rehabilitated with HOME funds must meet all applicable local codes, rehabilitation standards, ordinances, and zoning ordinances at the time of project completion.

Title 24 CFR 92.504(c)(3) provides that the agreement between the Department and a for-profit or non-profit housing owner, sponsor, or developer must describe the use of the HOME funds, including the tasks to be performed, a schedule for completing the tasks, and a budget. These items must be in sufficient detail to provide a sound basis for the participating jurisdiction to effectively monitor performance under the agreement.

Paragraph H, Article 6, of the July 8, 1998, Paseo Horizonte II Grant Agreement, states that the Department may suspend or terminate the agreement, in whole or in part, if the Developer fails to comply with any term or condition of the agreement, or with any of the rules, regulations or provisions referred in the agreement; and the Department may declare the Developer ineligible for any further participation in Department contracts, in addition to other remedies or sanctions provided by law.

Paseo Horizonte II

Paseo Horizonte II is new home construction consisting of 72 3-bedroom units housed in 6 12-unit walk-up type buildings. The project is located in Salinas, Puerto Rico. According to the Grant Agreement, dated July 8, 1998, with the Project Developer, $1.8 million of HOME funds were to be awarded to assist with 48 housing units. However, based on the Department’s records and HUD’s Integrated Disbursement and Information System, only $1,075,000 had been committed to the Paseo Horizonte II project. As of May 20, 1999, the Department had disbursed $656,100 of HOME funds to the Developer for site improvements and infrastructure work. The remaining $418,900 was not disbursed.

We determined that the Department disbursed HOME Program funds to the Paseo Horizonte II project for work that was not performed, not completed, and for excessive and ineligible costs. As a result, $29,085 of the $656,100 HOME funds disbursed to the Developer were ineligible and the remaining $627,015 was unsupported.

The main support for the disbursement voucher payments was the construction cost breakdown. The disbursements did not include support from the Developer/Contractor. The construction cost breakdowns, some undated, included the signature and stamp of the President, who represented both the Developer and the construction contractor entities. The President was a licensed engineer. However, the supporting documentation did not show certifications by a Department Inspector, or designee, verifying the certification by a licensed engineer in accordance with the Grant Agreement. Most of the disbursement documents were not stamped as paid or cancelled to avoid duplicate payments. We noted that two of the five disbursement checks were made payable to the Developer's President, instead of the Developer's entity.

We visited the site on December 5, 2002, and found it abandoned and unkempt. We observed underground infrastructure installations, an eroded landfill, and overgrown grass and bushes. The grill cover of a manhole was missing, exposing a hazardous hole 4 feet deep and 3 feet wide halfway filled with water.

Paseo Horizonte II - Salinas, Puerto Rico
View of Paseo Horizonte II showing the abandoned site.

The Developer explained that in 1999 he stopped the infrastructure work at the Paseo Horizonte II Project to obtain approval for an increase in HOME subsidy per low-income family. The request, according to the Developer, was prompted by problems he experienced in finding qualified homebuyers for Paseo Horizonte I, another State HOME Program funded project he developed next to Paseo Horizonte II. The Department HOME Program files document records of meetings and correspondence on this issue, including a March 2002 request from the HOME Program staff to the Program Director for instructions to either continue the project development or recoup HOME Program funds. However, no action was taken.

Upon inquiry, the current HOME Program Director indicated various reasons for lack of action, including change in key staff and reorganization of the division.

Further, at our request HUD's Multifamily Program Center, Caribbean Office staff performed a limited evaluation of the costs certified by the Developer for the HOME Program site improvements and infrastructure work as a result of concerns raised during an our site visit. The evaluation disclosed serious doubts that the work items claimed were completed according to specifications and if certain costs were reasonable. HUD's evaluation also concluded that certain costs line items were excessive or questionable. We identified ineligible costs of $8,985 for rubbish disposal and $20,100 for an ornamental block fence.

A former HOME Program Director approved the first disbursement dated July 8, 1998, totaling $424,500 and the cost breakdown, which was undated. The HOME Program Grant Agreement with the Developer was also dated July 8, 1998. According to the cost break down, the certification included 100 percent of insurance costs, temporary facilities, site clearing and rubbish disposal, and on site surveying and earthwork. The Developer indicated the project started in March 1998. Therefore, construction work started before a contract was executed reflecting lack of adequate controls.

Vilar Development

Vilar Development is new home construction consisting of 112 detached 3 bedrooms units. The project is located in

Barceloneta, Puerto Rico. A total of $2,240,000 was allocated for the project for program years 1999 and 2000. The project was still under construction and HOME funds totaling $1,629,086 had been expended as of December 20, 2002, for purchase of the site, infrastructure, and the construction of 18 houses in various stages of completion.

The HOME funds expended for the project were inadequately supported, and the files lacked construction permits and other required documents showing building compliance for a housing project located in an area susceptible to floodwaters. According to zoning codes, no construction was allowed in the areas where the project is located.

We visited the site on October 29, 2002. It appeared to have been abandoned for some time.

Partial view of houses under construction in block D.

Partial view of houses under construction in block E.

A HUD Appraiser assisted us in validating the costs charged to the HOME Program. The Appraiser's report valued the total project costs as of October 2002 at $1,727,000, including site acquisition, site improvement and infrastructure, and construction of the houses. The Appraiser's total valuation was comparable to the actual funds disbursed at that date.

Nevertheless, the appraisal value is contingent on key documentation, such as the construction permit, demonstrating compliance with applicable zoning requirements that the Department records lacked and the Developer did not provide. The appraisal report further stated that as of February 28, 1992, the local Planning Board Regulation clearly states no new construction was allowed in that zone.

Therefore, HUD lacked assurance that the amount spent for the Vilar Development would not result in a waste of Federal resources if the project development current zoning restrictions were not lifted. Further, completion of the project could endanger the lives and properties of low-income families that moved into the project, since the project is located in a flood zone. The $1,629,086 of HOME funds spent for the Vilar Development is ineligible, because the project does not meet HOME Program property standards.

Auditee Comments

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

"…The State HOME Program believes that the $29,085 is an eligible cost for the project Paseo Horizonte II. The Program Director and her legal advisor met with the developer to discuss the issues raised by the OIG funding. The developer has provided sufficient evidence to support the costs related to the rubbish disposal…. The developer has also agreed to fix the ornamental block fence at his cost…

"…The Department has concluded that it is in the best interest of the program for the developer to complete the Paseo Horizonte II development; he will receive no additional HOME funds.

"…The Department will pursue the developer of Vilar in a breach of contract action and seek a return of the $1,629,086 already disbursed to him. These funds will be returned to the HOME Investment Trust Fund upon receipt from the developer."

OIG Evaluation of Auditee Comments

The documentation provided by the Developer did not support Paseo Horizonte II actual cost. Adequate evidence includes cancelled checks, invoices, service order, and rubbish collection receipt showing the actual amount disbursed and that the cost was applicable to the Paseo Horizonte II project. Therefore, the costs remain ineligible.

For the Vilar Project, the Department agreed to seek reimbursement from the Developer of $1,629,086 of ineligible costs. Although the Developer abandoned the construction site, and may be liable for breach of contract, the Department has not provided adequate documentation to support building compliance for a housing development located in an area susceptible to floodwaters. Therefore, the Department should promptly reimburse its HOME

Investment Trust Fund $1,629,086 of ineligible costs for Vilar Development.

Recommendations

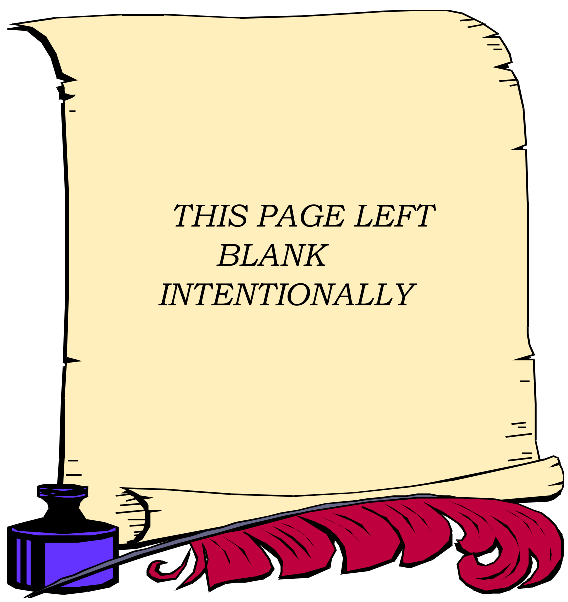
We recommend that you require the Department to:

2A. Reimburse its HOME Investment Trust Fund $29,085 of ineligible costs for Paseo Horizonte II.

2B. Determine if Paseo Horizonte II project development should continue and the eligibility of the $627,015 disbursed to the project. If the development continues, the Developer must provide personal funds, and complete the construction line items previously paid by the HOME Program. However, if the project is terminated, the ineligible costs should be reimbursed to the Department's HOME Investment Trust Fund and the remaining $418,900 could be put to better use.

2C. Reimburse its HOME Investment Trust Fund $1,629,086 of ineligible costs for Vilar Development and reprogram the remaining $610,914 to better use.

2D. Establish and implement policies and procedures for its HOME Program to ensure compliance with Title 24 CFR 92 and other HUD requirements. At a minimum the policies and procedures should ensure that: (1) fiscal controls and accounting procedures are sufficient to permit the tracing of funds to a level that ensures such funds have not been used in violation of the restrictions and prohibition of applicable statutes; (2) housing constructed or rehabilitated with HOME funds meet all applicable local codes, rehabilitation standards, ordinances, and zoning ordinances; (3) HOME funds are used in accordance with all program requirements and written agreements, and appropriate action is taken when performance problems arise; and (4) the agreement between the Department and a for-profit or nonprofit housing owner, sponsor, or development contains sufficient detail to provide a sound basis to effectively monitor performance under the agreement.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Management Controls

In planning and performing our audit, we considered the management controls of the Puerto Rico Department of Housing in order to determine our audit procedures, but 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 included the systems for measuring, reporting, and monitoring program performance.

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

- New Construction/Rehabilitation for Homeownership Activity project selection procedures;
- New Construction/Rehabilitation for Homeownership Activity project construction procedures;
- HOME funds disbursement procedures for New Construction/Rehabilitation Homeownership Activity; and
- Financial management procedures.

We assessed the relevant controls identified above by:

- Reviewing the regulations governing the program;
- Interviewing HUD, the Department and project development officials;
- Reviewing HOME project files and financial records;
- Inspecting projects; and
- Analyzing reviews and reports from HUD and from the Independent Public Accountants.

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 Department had an inadequate accounting system that did not properly account for or report program activities. (See Finding 1)

- The Department charged its State HOME Program ineligible expenses of $29,313. (See Finding 1)

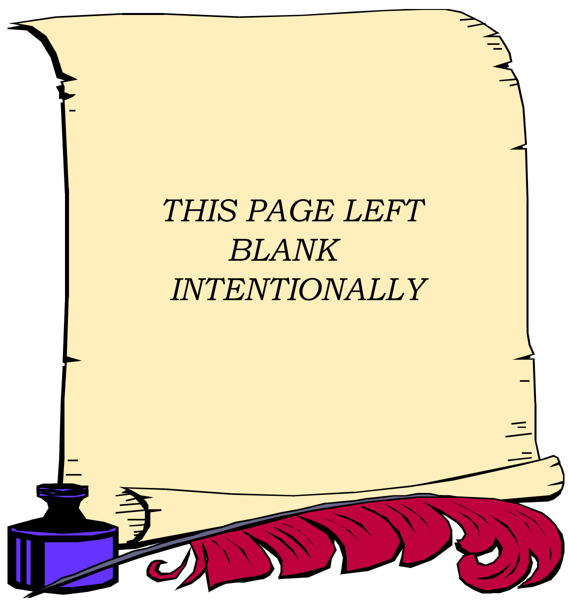
- The Department was not diligent in assuring adequate management of the day-to-day operations of its HOME Program. Thus, State HOME funds totaling $1,658,171 were ineligible, $627,015 were unsupported, and if the Department does not take corrective action an additional $1,029,814 could be misspent. (See Finding 2)

Follow-Up On Prior Audits

This is the first Office of Inspector General audit of the Puerto Rico Department of Housing's HOME Investment Partnership Program.

The Single Audit Report of the Department for the fiscal year ended June 30, 2001, was issued on March 15, 2002. The report contained a qualified opinion on both the general-purpose financial statement and on compliance with requirements applicable to each major program and on internal control over compliance. The report questioned costs totaling $1,380,700. Among the deficiencies reported were material weaknesses and reportable conditions applicable to the HOME Program. The report included 12 findings (6 Material Weaknesses and 6 reportable conditions) with total questioned costs of $97,152 concerning the HOME Program. The HOME Program questioned costs pertained to two reportable conditions: (1) disbursements were not properly supported ($52,970); and, (2) administrative expenses for the Community Housing Development Organizations were over the 10 percent authorized ($44,182). The material weaknesses applicable to the HOME Program included: (1) inadequate financial management controls and accounting procedures; (2) improper bank reconciliations; (3) lack of documentation evidencing participant's eligibility; (4) no control or procedures to obligate or use funds within the required time period; (5) period of funds availability not managed nor monitored; and, (6) unsupported federal funds receivable account.

Deficiencies similar to the above are reported in the Findings section of this report.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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/
1B	$ 29,313		
2A	29,085		
2B		$627,015	$ 418,900
2C	1,629,086		610,914
Total	$1,687,484	$627,015	$ 1,029,814

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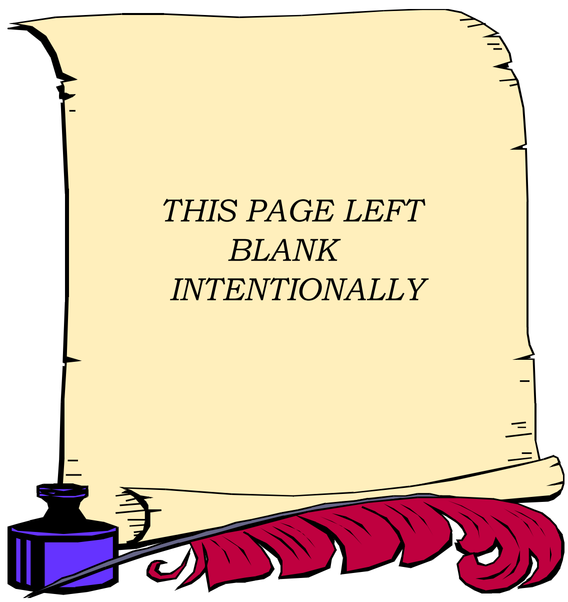
1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law, contract or Federal, State or local policies or regulations.

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. These funds include costs not incurred, and deobligation of funds.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Auditee Comments

DEPARTAMENTO DE LA
VIVIENDA
ESTADO LIBRE ASOCIADO DE PUERTO RICO

July 10, 2003

Ms. Nancy H. Cooper
District Inspector General for Audit Southeast/Caribbean
U.S. Department of Housing and Urban Development
District Office of the Inspector General
Office of Audit, Box 42
Richard B. Russell Federal Building
75 Spring Street, SW, Room 330
Atlanta, Georgia 30303-3388

Re: Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program

Dear Ms. Cooper:

This letter responds to the above-referenced audit performed by your office covering the period July 1, 2001 through June 30, 2002. The draft audit was provided to the Puerto Rico Department of Housing (the "Department") for review and comment on May 30, 2003. Comments were originally requested by June 27, 2003; by verbal communication, this due date was extended until July 11, 2003.

This audit was performed by your office at the request of HUD's Caribbean Office of Community Planning and Development regarding the result of its August 31, 2001 review of the program and the subsequent monitoring report. This monitoring report covered the HOME-funded activities from 1992-2000. This was the first and only monitoring report of this program by HUD since the inception of the program in Puerto Rico.

Avenida Barbosa 606, Edificio Juan C. Cordero, Río Piedras, PR • P O Box 21365 San Juan, PR 00928-1365
Tel. (787) 274-2525

The monitoring report prepared by HUD's Office of Community Planning and Development (CPD) covered the entire life of the HOME Program. During this period of time, from 1992 until 2000, the HOME Investment Partnership Program was managed by the previous Administration. Thus, when the current Administration took office in January, 2001, it adopted the programs with whatever procedures were in place at the time. In the case of the HOME Program, as with most of the other housing programs, the procedures in place were woefully inadequate.

This Administration took office on January 1, 2001. At that time, it found many serious problems at the Department that negatively affected its ability to function adequately. Many of the federally funded programs were either classified as "troubled" by HUD or were at serious risk of such a designation. The Department's annual budget was approximately $405 million in federal and state funds; therefore, this designation of troubled has serious implications. These problems were systemic throughout the Department and put in jeopardy the Department's ability to assist the low income families of Puerto Rico.

The most critical needs involved the creation of financial and management controls for all the agencies' programs, and creation of an internal management structure so that the Department could provide accountability to HUD and to respond to the corruption that was uncovered in certain programs.

The Puerto Rico Public Housing Administration (PRPHA), which is responsible for more than 56,000 units of housing, was beset with very serious and urgent problems. The procurement policies of the previous Administration were inadequate and faulty, resulting in

Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program
July 10, 2003
Page 3

an immediate need to bring the Department's procurement policies into compliance with federal requirements. Additionally, PRPHA's HOPE VI development was in serious trouble and at risk for a loss of funding. Puerto Rico entered into a voluntary transfer agreement with HUD for the management of the HOPE VI development in July 2001.

Also, the Choice Voucher Program was classified as troubled, with a SEMAP score of less than 20. The program was at risk of losing its funding and its eligibility for future funding. At the same time, the HOME program was severely impacted by the lack of an accounting, financial management and reporting system. Both the HOME and Choice Voucher programs had not prepared the single audit report for fiscal years 2000 and 2001, a cause for disclaimer opinions on both.

An independent audit ordered by Secretary Echegoyen in January, 2001, issued a disclaimer opinion based on the lack of the most basic accounting system at the Department. Given the seriousness and magnitude of those problems, the new Administration focused its efforts on resolving those with the greatest impact on the Department's compliance with program needs.

HUD staff, both the Caribbean and National Offices, have provided the Department significant technical assistance in revamping its operations and practices. Substantial improvement has occurred in the two and a half years since January, 2001. All the HOPE VI findings were cleared and the development returned to PRPHA which has obtained a clean opinion on its financial statements. The agency was reorganized, new internal and external monitoring systems were put in effect to supervise and control the

Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program
July 10, 2003
Page 4

private management agents and modernization contracts. Recent HUD monitoring reports attest to the substantial progress in its operations. For the first time in PRPHA history, the agency will be obligating all of its Capital Improvement Funds within the current fiscal year, thus complying with the obligation deadline.

The Choice Voucher program is now classified as "standard" by HUD's Caribbean Field Office after the submission and acceptance of the SEMAP for fiscal year 2002. As set out more fully below, the HOME Program is now nearing complete compliance with all program requirements.

As part of the overall Departmental reorganization, for Finance and Information Systems was reorganized; fiscal functions were divided, an accounting system was installed and implemented, and the monitoring of funds was incorporated into the system. New personnel were hired to support the financial functions. As a result of these improvements, the latest single audit issued a qualified opinion.

The HUD review of the Puerto Rico State HOME Program was initiated in April, 2001, a mere three months after this Administration took office. It was the first review by HUD of this program in the nine years that HUD had been funding the program. As of August, 2001, the HUD monitoring report had ten findings which are identified in the OIG audit. While not reflected in the OIG audit, as of April, 2003, five of these findings had been cleared, one is resolved and will be cleared upon final reimbursement. See Exhibit 1, Monitoring Progress Report, April 1, 2003. Additionally, two additional findings will be cleared by August 1, 2003. One of these findings, Finding 1 – Grant

Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program
July 10, 2003
Page 5

Administration/Financial Management, is the heart of Finding 1 of the OIG audit. This finding has been resolved, as evidenced by the letter of July 8, 2003, sent by Mrs. Carmen Cabrera to Secretary Echegoyen, included as Exhibit 2.

Finding 1: The HOME Program Grants were unauditable.

This finding is based primarily on the status of the HOME Program at the conclusion of the previous Administration. As with other programs within its administration, the Department found itself with a program with very few safeguards in place.

Soon after taking responsibility for the management of the housing programs for Puerto Rico, the Department began a complete overhaul of every agency within its jurisdiction (see discussion, infra.). This included the HOME Program. Before this could occur, however, the Office of Finance and Information Systems had to establish the necessary accounting systems in order to manage the finances of the Department.

In March, 2003, the Certified Public Accountant (CPA) firm of Scherrer Hernandez & Co. was retained by the Assistant Secretary for Finance and Information Systems to evaluate and determine the adequacy of the existing internal control structure and policies and procedures for the financial management of the HOME Program. As part of its responsibilities, Scherrer Hernandez & Co. developed a management accounting system, known as the Management Accounting and Reporting Tool ("MART"). MART provides:

1) records identifying the source and application of funds for each fiscal year, including the formula allocation, and any reallocation;

2) information and reconciliation concerning the HOME Investment Trust Fund Treasury account and local account;

3) records related to source and application of program income, repayments and recapture funds; and,

4) information related to a budget that will assist the local HOME office to adequately control expenditure of program funds.

On June 30, 2003, Scherrer Hernandez and Co. rendered its opinion that MART complies in all material respects with 24 C.F.R., Part 85.20. See Exhibit 3. Thus, while the OIG audit findings may have been an accurate reflection of the program when this Administration assumed responsibility for the program, they are no longer accurate. The HOME Program under this Administration is now in full compliance with its financial management obligations under the HOME Program. See Exhibit 2.

OIG Finding: Accounting System Remained Inadequate

Nevertheless, there appears to be some confusion as to the role of the mechanized accounting system known as "Emphasys," which is used by the Office of Finance and Information Systems to record all transactions and reconcile funds from previous fiscal years. The OIG draft audit concluded that Emphasys was flawed because it failed to identify expenditures by Federal fiscal year appropriation, did not reflect program expenditures prior to fiscal year 2002 and did not include the HUD budget for each activity.

Emphasys is an accounting system, not a financial management system. (MART is the financial management system.) As an accounting system, Emphasys is designed to record financial transactions in order to produce accounting reports that show the financial position of the entity at any specific moment in time. This includes, for example, a general ledger and

Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program
July 10, 2003
Page 7

its corresponding subsidiary ledgers of account payable, accounts receivable and other reports necessary to maintain proper accounts in an auditable state.

Thus, the OIG was looking to the Emphasys system to provide information it was not designed to provide. Emphasys is properly providing its accounting function, and the MART system is now in place to generate the financial management tools that were lacking under the previous Administration. Additionally, all posting of accounting transactions are current.

Lastly, the OIG indicated that the Department would not commit adequate staffing to correct the deficiencies in the financial management system. This is simply not an accurate portrayal of what occurred.

The Assistant Secretary for Financial and Information Systems retained two separate contractors to assist his office in meeting its program responsibilities. First, the CPA firm of Rodriguez & Espada were hired to assist in reconciling eight years of funding. As previously referenced, Scherrer Hernandez & Co. was also hired to evaluate and analyze the Department's HOME Program and to determine the adequacy of the then existing internal control structure. Based on its analysis, in mid-April, 2003, Scherrer Hernandez & Co. recommended, among other things, that the HOME Office assume financial and accounting management responsibilities (then held by the Office of Finance and Information Systems) and that HOME personnel assigned to the Office of Finance be used by the HOME office. The recommendations of Scherrer Hernandez & Co. were adopted by the Department the day after it was received. This included increasing the HOME staff.

The OIG audit language therefore leaves its readers with a false impression of the actions of the Assistant Secretary of Finance. The report portrays the Assistant Secretary as unwilling to " . . . adversely affect the daily operations of his department . . . ." Instead of this negative inference, the Assistant Secretary should have been recognized for hiring outside assistance and using his valuable resources for other tasks until he received the recommendations the Department had paid for, which, once received, were acted upon promptly.

OIG Finding: Program Income Not Properly Reported

Program income was in effect overstated in IDIS as a result of the entry of recaptured funds being entered as program income. This was an entry error that is being corrected with the assistance of HUD's Financial Analyst, Mr. Andrés Delgado. The related administrative allowance for program income that results from the recaptured funds was wrongly recorded as program income (recorded in the Administration Program Funds), but has not been utilized by the program. It is in the process of being restated to the corresponding recapture account.

This was inadvertent error, and evidence of its correction will be submitted to HUD. The future occurrence of similar errors is being reduced by the establishment and implementation of the MART accounting and reporting system which complies with 24 C.F.R. § 85.20 and other applicable regulations. As stated in its letter of July 8, 2003 (included as Exhibit 2 of this document), HUD has accepted MART as established and implemented. The implementation of MART allows the HOME Program to maintain its own accounting and financial management system. Program records will be continuously reconciled with the Department's accounting system, Emphasys. MART provides accurate records related to sources and application of program income as well as recaptures and repayments. The HOME Program management will be verifying the correctness of MART entries on a monthly basis. Enclosed as Exhibit 4 is a printout of the Program Income account produced by MART as of July 1, 2003.

OIG Finding: Expenditures Not Allowable

The OIG concluded that the Department paid $6,383 in college tuition for its employees and charged it as an administrative cost of the HOME program. The OIG concluded that the courses taken by the employees were not related to the HOME program and therefore not eligible expenses of the program.

Administrative Order 98-46 authorizes the Department of Housing to pay for the enrollment in courses related to duties and responsibilities of an employee's position within the Department. Thus, if these courses have a reasonable relationship to the employee's performance of their responsibilities under the HOME Program, the Department's position is that these are legitimate HOME administrative expenses.

The HOME Program Director has reviewed the courses taken and the job descriptions of the employees. As a result of this analysis, the Program Director has determined that $3,319.00 used to pay employees' college courses was directly related to their responsibilities. The amount of $3,064.00 expended in tuition not sufficiently related to the program will be reimbursed to the HOME Program account. See Exhibit ____

Additionally, the OIG audit determined that professional services were charged to the home Program that were not for services rendered on behalf of the HOME Program. The Planning and Technical Division of the Puerto Rico Department of Housing was in charge of the Section 8 and HOME programs. As a result of the organization of the office, and the corresponding overlap of some duties and responsibilities, the Department believes that many of the tasks identified were properly attributed to the HOME Program. However, the Department acknowledges that there were some tasks that were not related to the HOME Program, and therefore is preparing a pro rata allocation of costs. The costs determined to be non-related to the HOME Program will be reimbursed to the Program by the Department.

OIG Conclusion – Finding 1

Finding 1 concludes that, despite the receipt of technical assistance from HUD, the Department still has not established written guidelines and procedures for its program management or financial management system. This is not accurate. In January, 2002, the State HOME Program office submitted to the HUD field office a copy of the draft Policy Statement and Financial Administration which set forth the HOME Program policies and procedures for financial management, accounting, budget development and control. The HUD field office has provided its comments, and they have been incorporated into the Policy Statement. Additionally, Scherrer Hernandez & Co. have prepared the necessary guidance on Emphasys and MART, and it will be incorporated into the Policy Statement.

Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program
July 10, 2003
Page 11

As of April, 2003, the HOME program had developed and implemented the following procedures, controls and related measures, which have been received and accepted as in compliance by the HUD program staff:

1) Financial and Accounting Management Systems
2) RFP Procedures/Evaluation Criteria/New Proposal Evaluation Committee
3) Procurement Procedures for Professional Services
4) Procedures for the Rehabilitation or New Construction by Homeowner
5) Monitoring Procedures and Checklists/Implementation
6) Rent verification, income eligibility re-certification
7) Eligibility Certification Procedures
8) Subsidy Layering Analysis Procedures
9) Reorganization of the Operation of the Program
10) Housing Rehabilitation Standards
11) HQS Inspections
12) Environmental Review Guidelines

In addition, written guidance on the Emphasys and MART systems is in process and program staff is reviewing the draft submitted by the consultants.

Therefore, as to the recommendations for Finding 1, the Department's response is as follows:

1A. There is no need to suspend disbursements of HOME funds for any further awards because the Department has reconciled or is reconciling all previous years' grants and has thus demonstrated accountability and compliance for its HOME grants.

The Department has reconciled the grant years 2001 through 2003, and this was accepted by HUD's Caribbean Office. The contracted CPAs are actually working on reconciling years 1992-2000 to meet the completion deadline of September 30 established by HUD. It is anticipated that this deadline will be met.

1B. It has been determined that $3,064.00 expended in tuition was not in accordance with Administrative Order 98-46 and will be repaid to the HOME Investment Trust Fund.

1C. The Department agrees to have an annual independent audit performed until all grants are properly accounted for or recovered.

Finding 2: The New Housing Development/Rehabilitation for Homeownership Activity Did Not Accomplish Its Intent for Two Projects Reviewed.

The OIG audit reviewed three projects granted HOME funds by the previous Administration. The OIG audit determined two of the three projects were not in compliance with program requirements due to inadequate management controls, and as a result, concluded that $1,876,871 of HOME funds were ineligible, $408,315 were unsupported, and there was risk of $1,029,814 being misspent if corrective action is not taken immediately.

Paseo Horizonte II

The first project, Paseo Horizonte II, was to be funded with $1.8 million of HOME funds to assist in the new construction of 48 of the 72 housing units in the development. As of May, 1999, the Department had disbursed $656,000 of the HOME funds to the developer for site improvement and infrastructure.

The OIG visited the site in December, 2002, and found it abandoned. The OIG further determined that $218,700 of the funds disbursed for infrastructure were allocable to the 24 units that were not to be funded with HOME funds, and thus this $218,700 was an excess cost to the project and needed to be recaptured.

The OIG determined that the developer stopped construction in 1999 in order to obtain HUD approval for an increase in the HOME subsidy per low-income family. This was necessary because of the difficulty in finding qualified home buyers. After much review, it has been determined by the State HOME office that this project is viable and should be completed. The developer will complete this project with no new funds.

Vilar

The Vilar development was a new construction project approved in 1999 and 2000. As of December, 2002, the project was still under construction and HOME funds totaling $1,629,086 had been expended. The OIG concluded that according to zoning codes, no construction was allowed in the area where the project is located. The OIG concluded that the expenditure of these HOME funds was ineligible because the project does not meet HOME program property standards. This conclusion is based on the belief that the zoning did not permit this construction and no construction permit was obtained.

While it is true that the developer has breached his contract with the Department to build this development, the assertion that he did not receive authorization to build this project in the flood plain is not correct. <u>See</u> Exhibit 6, FEMA letter, dated September 22, 1997 to Ms.

Norma E. Burgos-Andujar, approving the construction. Thus, the funds were not improperly committed to this development.

OIG Conclusions – Finding 2

Therefore, as to the recommendations for Finding 2, the Department response is as follows:

2A. The State HOME Program believes that the $29,085 is an eligible cost for the project Paseo Horizonte II. The Program Director and her legal advisor met with the developer to discuss the issues raised by the OIG funding. The developer has provided sufficient evidence to support the costs related to the rubbish disposal, submitted as Exhibit 7. The developer has also agreed to fix the ornamental block fence at his cost, evidence submitted as Exhibit 8.

The HOME Program has determined that it is the best use of funds to complete the Paseo Horizonte II project as it will supply the critical need of affordable housing for 72 very poor families. The Program is preparing an amendment to the original contract that will incorporate the rest of the 24 units (of the total 72 units of this project) as HOME assisted units. The project completion date has been established for September, 2004.

2B. The Department has concluded that it is in the best interest of the program for the developer to complete the Paseo Horizonte II development; he will receive no additional HOME funds.

Draft Audit Report
Puerto Rico Department of Housing
State HOME Investment Partnership Program
July 10, 2003
Page 15

2C. The Department will pursue the developer of Vilar in a breach of contract action and seek a return of the $1,629,086 already disbursed to him. These funds will be returned to the HOME Investment Trust Fund upon receipt from the developer.

2D. This has already been accomplished. See Exhibit 9.

This document represents our comments to your Audit Report regarding the HOME Program. I hope that based on the information herein included the final audit report will accurately describe the management of the Program from 1992 to 2003.

Cordially,

Ileana Echegoyen