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Audit Case Number	97-AT-241-1003

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

FROM: Nancy H. Cooper
District Inspector General for Audit-Southeast/Caribbean, 4AGA

SUBJECT: Municipality of Mayaguez
Community Development Block Grant and
Section 108 Loan Guarantee Assistance Programs
Mayaguez, Puerto Rico

We have completed an audit of the Municipality of Mayaguez (grantee) pertaining to its Community Development Block Grant (CDBG) and Section 108 Loan Guarantee Assistance (LGA) Programs. Our objectives were to determine whether the grantee carried out these activities in an economical, efficient, and effective manner, and complied with applicable laws and regulations.

We found serious deficiencies in the grantee's administration of the HUD programs. The grantee did not:

- (1) timely and effectively administer the LGA activities;
- (2) adequately demonstrate that each activity met at least one of the national objectives of the CDBG Program;
- (3) properly monitor the activities of a subrecipient;
- (4) adequately charge costs that are eligible, allocable, reasonable, and properly supported; and
- (5) maintain an adequate financial management system for the CDBG and LGA Programs.

These weaknesses resulted in ineligible and unsupported costs of \$4,724,934 and \$2,224,877, respectively. Additionally, there were opportunities for cost efficiencies of \$3,365,180.

We are providing a copy of this report to the auditee.

Within 60 days, please furnish this office for each recommendation cited in the report, 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 not considered necessary. Also, please furnish us copies of any correspondence or directives issued as a result of the audit.

We appreciate the cooperation of your staff during this audit. Should you or your staff have any questions, please contact James D. McKay, Assistant District Inspector General for Audit (404-331-3369) or Aurora Rodriguez, Senior Auditor (766-5879).

Executive Summary

We examined the operations of the grantee pertaining to its CDBG and Section 108 LGA Programs. The purpose of the examination was to determine whether the grantee: (a) carried out its activities in an economical, efficient, and effective manner, (b) complied with the CDBG and LGA program requirements, laws and regulations; and (c) had adequate controls to ensure compliance with U.S. Department of Housing and Urban Development (HUD) regulations, policies, and directives.

The grantee did not efficiently and effectively manage CDBG or LGA activities. As a result, the grantee incurred more than \$4.7 million of ineligible costs and \$2.2 million of unsupported costs. Also, there were opportunities for cost efficiencies of an additional \$3.3 million. The grantee did not comply with program requirements pertaining to: use of CDBG funds, program income, procurement practices, financial management system, national objectives, program progress, and other matters.

Specifically the review disclosed:

- The grantee did not adequately plan or monitor its Section 108 LGA activities to ensure completion. Funds were used for over \$2.4 million in ineligible and over \$1.8 million for unsupported activities.
- Controls over program income were inadequate. The grantee neither reported nor accounted for program income of \$2.7 million obtained from activities assisted with CDBG and LGA funds.
- CDBG funds of more than \$1.4 million were improperly used to pay the salaries of municipal employees carrying out general government responsibilities of the municipality. Additionally, \$562,443 budgeted for FY 1996-97 is a cost efficiency.
- The grantee charged the CDBG and LGA Programs \$441,800 for unnecessary engineering services.
- The grantee used CDBG Program funds for road improvements, but did not maintain documentation to demonstrate compliance with the CDBG national objectives. It also incurred ineligible maintenance and repair costs resulting in \$178,059 and \$36,054 of ineligible and unsupported costs, respectively.
- The grantee used \$97,334 of CDBG Program funds for ineligible administrative expenditures.
- The grantee continued charging the CDBG Program for the lease of equipment, after the state of emergency for which the funds were authorized, had ended. Expenditures in the amount of \$44,500 were ineligible.

- The grantee did not administer its housing rehabilitation program in an effective and efficient manner. As a result, \$3,000 was ineligible, \$17,706 was unsupported, and \$6,472 was a cost efficiency.
- The grantee's financial management system and procurement practices needed improvement. The accounting records were deficient, financial reports were not timely or accurate, and there were no assurances that services and goods were acquired at the most advantageous terms. Accordingly, \$1,000 was ineligible and \$310,533 was unsupported.

We recommend that your office require the grantee to reimburse the ineligible costs and determine the eligibility of the unsupported costs (see Appendix A). We also recommend that you consider imposing strong administrative sanctions if the grantee can not demonstrate significant improvements in its operations.

Auditee Comments

We provided draft findings to the grantee on December 12, 1996. An exit conference with grantee officials and legal representatives was held on January 22, 1997. The grantee provided its written comments on January 29, 1997. The grantee generally agreed with the findings. The auditee comments are summarized in the auditee comments section under each finding. The auditee comments are provided in their entirety in Appendix B.

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Abbreviations		
CDBG	Community Development Block Grant	
CFR	Code of Federal Regulations	
CPDO	Corporacion para el Desarrollo del Oeste (Subgrantee)	
EDA	Economic Development Agency	
FTA	Federal Transportation Agency	
FY	Fiscal Year	
GPR	Grantee Performance Report	
HUD	U.S. Department of Housing and Urban Development	
LGA	Section 108 Loan Guarantee Assistance	
OMB	Office of Management and Budget	
UDAG	Urban Development Action Grant	
UMTA	Urban Mass Transportation Agency	

Introduction

BACKGROUND

The Municipality of Mayaguez was organized under the laws of the Commonwealth of Puerto Rico and is governed by a municipal assembly composed of 16 elected members. The Mayor is Jose G. Rodriguez, whose office is located at the Mayaguez Municipal Hall. The grantee's Federal Programs and Housing Department was responsible for administering the CDBG and LGA Programs under the direction of Noemi Cardona. The program books and records were maintained at the Federal Programs and Housing Department.

During the audit period, the grantee administered entitlement grants totaling \$41,650,000 for program years 1986 through 1996. The grantee was also administering a 1988 Section 108 LGA totaling \$5,000,000.

The latest Grantee Performance Report (GPR) for the period ending June 30, 1995, reflected expenditures for the CDBG and Section 108 LGA Programs of \$3,543,950 in the following eight major categories:

Housing Rehabilitation	\$ 980,606
Public Service	710,514
Public Facilities	487,404
LGA Repayment	340,813
Interim Assistance	179,761
Economic Development	43,040
Acquisition Real Property	2,069
Program Administration	<u>799,743</u>
Total	<u>\$ 3,543,950</u>

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to determine whether the grantee: (1) carried out its CDBG activities in an economical, efficient, and effective manner; (2) complied with CDBG Program requirements, laws, and regulations; and (3) had adequate controls to ensure compliance with HUD regulations. Our objectives in reviewing the Section 108 LGA Program were to determine whether the grantee made effective use of the loan proceeds to meet a CDBG national objective and whether it complied with loan application requirements, applicable laws, regulations, and HUD policies and directives.

The audit covered the period from July 1, 1994 through December 31, 1995. However, we extended the audit coverage to September 30, 1996, and to prior periods when necessary to meet our audit objectives. We also extended audit coverage in areas where audit reports from the Puerto Rico Comptroller disclosed serious deficiencies. Our field work was performed between February 1996 and January 1997.

In planning our audit, we considered:

- HUD's monitoring reports on the grantee;
- GPRs;
- the grantee's system of internal controls;
- reports of prior audits; and
- reports from the Puerto Rico Comptroller.

Our audit tests primarily focused on activities reported in the latest GPR for the period of July 1, 1994, to June 30, 1995. The GPR reflected expenditures of \$3,543,950 during this period. Our tests were extended to cover an activity undertaken by a subgrantee which was completed prior to this GPR reporting period. We made site inspections at selected projects. We also reviewed the administrative costs charged to the CDBG Program. The audit tests were designed to enable us to determine the grantee's compliance with national objectives, program progress, procurement procedures, and eligibility requirements. All audit tests were based on judgmental selection.

Our audit was conducted in accordance with generally accepted government auditing standards.

The Grantee Did Not Properly Manage Section 108 LGA Activities

The grantee did not adequately plan or monitor its Section 108 LGA activities to ensure completion. Funds were used for over \$2.4 million in ineligible and over \$1.8 million for unsupported activities. Consequently, the grantee failed to meet the program objectives.

CRITERIA

The LGA contracts between HUD and the grantee specified that the funds be used only for approved activities. Office of Management and Budget (OMB) Circular A-87, titled Cost Principles for State and Local Governments, paragraph C.1.a, states that to be allowable under a grant program, costs must be necessary and reasonable for proper and efficient administration of the grant program, be allocable thereto under these principles, and except as specifically provided, not be a general expense required to carry out the overall responsibilities of State or local government. A cost is allocable to a particular cost objective to the extent of benefits received by such objective (paragraph C.2a.). Any cost allocable to a particular grant or cost objective under the principles provided in the circular may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons (paragraph C.2.b).

Title 24 Code of Federal Regulations (CFR) Part 570.703 (l) provides that buildings or portions thereof used for the general conduct of the government cannot be assisted with Section 108 LGA funds. Public facilities for the general conduct of government include state office buildings according to 24 CFR 570.3.

24 CFR 570.505(a) specifies that a recipient may not change the use or planned use of any such property (including the beneficiaries of such use) from that which the acquisition or improvement was made unless the recipient provides affected citizens with reasonable notice of, and opportunity to comment on, any proposed change. Any new use of such property must qualify as meeting one of the national objectives in 570.208 (formerly 570.901) and not be a building for the general conduct of the government. If the grantee decides after consultation with affected citizens that it will retain the land for an ineligible use, then it should reimburse the CDBG/LGA Program in the amount of the current fair market value of the property.

1989 SECTION 108 LGA ACTIVITIES NOT CARRIED OUT

In February 1989, HUD approved a \$5 million loan to the grantee to attract the involvement of private enterprise. On March 16, 1992, the grantee submitted an amendment requesting an extension of time and changes in the activities. Later (February 3, 1994), the grantee advised HUD of their intention to again amend the application in order to allocate \$1,000,000 for the establishment of a Loan Fund Program. HUD approved the amendment on November 18, 1994. The approved amendment required that all funds (\$5 million) be disbursed by August 1, 1995. However, at September 1996, the grantee was in the process of requesting a third amendment. Although 8 years have passed since HUD approval, the grantee has not carried out any of the activities for which the LGA funds were intended.

On June 6, 1995, the grantee submitted a new application for \$22,770,000 to carry out additional activities and to refinance the balance of \$3,725,000 on the \$5,000,000 LGA loan. The grantee claimed (in Resolution Number 37-A Series 1994-1995, dated December 19, 1994) that LGA funds had been used for a waterfront development program. The grantee's statement was not correct, because the grantee had not carried out any of the activities. At our audit date, HUD had not approved the new loan request.

From February 1991 to July 1996 the grantee paid \$3,570,201 on the \$5 million LGA loan, of which \$2,316,652 were paid with CDBG program funds. We consider the \$2,316,652 ineligible, because there were no benefits received.

LAND AT SABALOS WARD NOT USED AS INTENDED

On June 13, 1986, the grantee paid \$30,250 for the acquisition of a land lot of 7,937 square meters located at Sabalos Ward. The grantee's plans were to transfer the property to the Corporation for the Development of the West (CPDO), a non profit corporation.

At October 31, 1996 the property had not been transferred to CPDO. Further, the Puerto Rico Controller's audit report dated June 30, 1995 disclosed that the property had not been registered in the name of the grantee at the Puerto Rico Property Register. The grantee had not prepared a resolution and necessary documents to register the property. Therefore, the grantee had not complied with the state requirements and was not adequately safeguarding program assets.

Our site visit disclosed that there was no economic and community development activity for the land acquired 10 years ago. Additionally, a grantee official indicated that there was no plan on what to do with the land. In fact, the official was not aware that the land was acquired with Section 108 LGA funds. This demonstrates that the grantee is not efficiently or effectively managing its Section 108 LGA Program to obtain intended results. The \$30,250 paid for the land was unsupported because the grantee had not identified a proper use for the property.

BORINQUEN AVENUE PROPERTY NOT OWNED OR USED AS INTENDED

On May 16, 1980, the grantee paid \$276,894 for the acquisition of 6,515 square meters of land located adjacent to Borinquen Avenue. The grantee's records indicated the land was acquired for the construction of commercial facilities to stimulate private investment and to provide long-term employment for low and moderate income persons.

The grantee's records showed that the 6,515 square meters included 3,498 square meters for which the seller did not have ownership. As a result, the grantee paid \$148,682 for land it did not own. At our audit date, the grantee was in the process of suing the seller for reimbursement of the money paid in excess. The \$148,682 is an ineligible cost.

Additionally, there had been no economic development activity on the land since its acquisition. The grantee was in the process of widening Peral Avenue, and constructing sidewalks, water fountain, etc., which involved the use of a portion of the acquired land. Grantee officials did not know the amount of land to be used for that purpose. Therefore, \$128,212 representing the remaining cost of the land (after deducting the \$148,682) is considered unsupported pending an eligibility determination by HUD because the land is not being used for the original intended purpose.

1979 SECTION 108 LGA PROGRAM NOT MONITORED

The grantee acquired 84.6 "cuerdas"¹ of land in 1980 with 1979 Section 108 LGA funds. The LGA loan application specified that the land would be acquired for the development of housing and for public cemetery facilities. In 1984, the grantee transferred all the land to CPDO for the construction and sale of housing units, commercial areas and any needed infrastructure for a project to be known as Villa Sultanita. The deed broadly mentioned the intended use of the land. The grantee did not execute a written agreement with the subgrantee as required by 24 CFR 570.503 and had not properly monitored the subgrantee to assure that program objectives were met.

At the audit date, the subgrantee had used the land as follows:

<u>Use</u>	<u>"Cuerdas"</u>
Development of Housing	47.1
Commercial Use	7.3
State Police Headquarters (Western Region)	4.1
Lots sold to private citizens	0.7
Pending to be sold for commercial use	1.6
Returned to the Grantee	<u>1.0</u>
 Total	 <u>61.8</u>

¹ A "cuerda" is about 3,930 square meters.

After 12 years from the transfer of land to the subgrantee, there were still 22.8 "cuerdas" with an acquisition price of \$384,255 that had not been used. Therefore, the grantee had not accomplished the activity for which the LGA funds were intended. Accordingly, we consider the \$384,255 as unsupported.

We noted the following deficiencies regarding the land that had been used:

LAND USED FOR CONSTRUCTION OF STATE POLICE HEADQUARTERS

The grantee used 4.1 cuerdas of the land for the construction of a State Police Headquarters for the Western Region.

On October 24, 1994, the Mayor notified the Executive Director of the State Public Buildings Authority that the municipality endorsed and supported a project for the construction of a State Police Headquarters. On December 9, 1994, the Mayor restated endorsement for the State Police Headquarters on the land that had been transferred to CPDO for development of housing. The subgrantee disagreed with the proposed use of the land for the construction of the State Police Headquarters. Finally, the Public Buildings Authority acquired the land through eviction for \$815,560.

The acquisition of land for construction of public facilities for the general conduct of government is not an eligible activity. As discussed in Finding 2, the amount of \$815,560 should be recorded as program income.

LAND USED FOR CONSTRUCTION OF STATE INSURANCE FUND BUILDING

On March 27, 1989, the subgrantee sold two "cuerdas" of land to G.A. Investment Company, Inc. (developer of Villa Sultanita housing) for the construction of a building. A building was constructed and rented to a State governmental agency known as "Fondo del Seguro del Estado" (State Insurance Fund - Worker's Compensation). The land sale proceeds were \$353,735.

Neither the subgrantee nor the grantee documented how this activity met at least one of the three national objectives: benefitting low and moderate income persons, eliminating slum and blight or to alleviate an emergency situation. Furthermore, the property was being used for the general conduct of the government, which is not allowable. As discussed in Finding 2, the amount of \$353,735 should be recorded as program income.

LAND FOR AUTOMOBILE PARTS STORE NOT USED

In March 1993 the subgrantee sold to NAPA Auto a land lot of 2,293 square meters (.58 "cuerdas") for \$155,178. NAPA constructed a building for distribution of auto parts. However, our site inspection in October 1996 disclosed the business was not operating. Therefore, it was not being used for activities to benefit low and moderate income persons. The .58 "cuerdas" are

part of the 7.3 "cuerdas" which is shown as used for commercial uses. We consider the \$155,178 as unsupported, because the property was not being used as intended.

LAND SOLD TO A PRIVATE CITIZEN NOT SUPPORTED

In 1995, the subgrantee sold two land lots totaling .7 "cuerdas" (2,748.08 square meters) to a private citizen. Neither the subgrantee nor the grantee records showed the purpose or justification for the sale. The sale price was \$10 per square meter for a total of \$27,481. The subgrantee did not obtain appraisals or advertise for bids to justify the price of \$10 per square meter. Other properties in the area were sold at \$50 per square meter. The \$27,481 is considered unsupported pending an eligibility determination by HUD.

LAND IN OPTION STATUS NOT SUPPORTED

The subgrantee sold two lots. The subgrantee informed us that the land is to be used for commercial activity. The land lots with sales options are the following:

<u>Potential Purchaser</u>	<u>Square Meters</u>	<u>Unit Price</u>	<u>Total</u>
Centro Equipos, Inc.	2,553.40	\$ 68.48	\$ 174,856
Carmelo Maldonado	<u>3,715.28</u>	75.00	<u>278,646</u>
Total	6,268.68		\$453,502

The subgrantee did not maintain records to demonstrate how the activities will meet at least one of the three national objectives, and no activities have been carried out. Consequently, the expected proceeds of \$453,502 is questioned pending a final determination by HUD.

LAND FOR HOUSING DID NOT BENEFIT LOW/MODERATE RESIDENTS

From the 47.1 "cuerdas" used by the subgrantee for the development of housing, 41.5 "cuerdas" were used for housing that did not benefit low and moderate income persons.

The first phase of Villa Sultanita comprised the development of 100 housing units for which the grantee received an Urban Development Action Grant (UDAG) grant of \$8,750 per unit. The units were to be sold to families with annual incomes not exceeding \$13,500. However, the grantee's records showed that 94 of the 100 units were sold to families with annual incomes exceeding the \$13,500. In fact, 39 families had annual incomes ranging from \$20,000 to \$32,000. As a result, units were sold to other than low and moderate income families.

Phase II of Villa Sultanita housing comprised the development of 127 housing units with a sale price of \$40,000 which was higher than the UDAG assisted units. These units were sold during 1988. Considering that these units had a higher sales price than the UDAG units, the income needed to qualify as a purchaser would be higher than the income needed to qualify for the

UDAG units. The grantee records did not show that this activity benefitted low and moderate income persons. Therefore, \$699,412 representing the acquisition price of the 41.5 "cuerdas" is considered unsupported pending an eligibility determination by HUD.

AUDITEE COMMENTS

Grantee officials stated an amendment to the 1988 LGA Program was pending HUD approval. Their comments included a description of the proposed activities.

Grantee officials stated the Sabalos Ward property was not registered because the property did not have an independent access to roads. They advised the land now has independent access and that they want to preserve the property. They are evaluating possible uses of the land.

Grantee officials explained they paid an excessive price for the Borinquen Avenue property because the acquisition price was not based on a unit cost. They also claimed the "transaction title" did not specify the amount of land acquired. They also contend the property was acquired to expand Borinquen and Peral Avenues and that the use is consistent with the original plans.

The grantee generally concurred with the issues concerning the 1979 LGA activities. Grantee officials stated that they had taken actions against the subgrantee for the improper use of the land. This includes among others, a lawsuit claiming compensation for damages and prejudices. The grantee also claimed that during their administration (last four years) the subgrantee has been reluctant to give them access to records, delaying their monitoring activities.

With respect to the land used for the construction of the Police Headquarters, the auditee stated that although the Mayor endorsed the project, the endorsement had little effect because there was an eviction from the central government, which they could not prevent. With respect to the other land lots mentioned in the finding, the auditee either agreed or reported that it is in the process of gathering information to evaluate the matter.

EVALUATION OF AUDITEE COMMENTS

The grantee's reply concerning the amendment disclosed that one of the proposed activities (Paseo Costero) needs to be redesigned and will have to re-start the permit process with all concerned agencies. This will undoubtedly continue delaying the completion of the activities, although funds were provided in 1989.

We believe the auditee was negligent not to determine the ownership of the Borinquen Avenue property. The grantee's statement that the "transaction title" did not specify the land acquired is not correct. The sales deed does describe the amount of property acquired. We believe the expansion of Borinquen and Peral avenues is not consistent with the stated objective for the construction of commercial facilities to generate long term employment of low and moderate income persons.

The grantee's statement that during the last four years they have not been able to monitor the subgrantee does not address our point that the main cause of the deficiencies discussed in this finding was the lack of timely monitoring over the subgrantee. They are silent with respect to the previous 8 years. Although there was another administration, the records should show the intent of their monitoring efforts.

RECOMMENDATIONS

We recommend that you:

- 1A Require the grantee to pay-off the 1989 Section 108 LGA and terminate the LGA agreement.
- 1B Require the grantee to reimburse the CDBG Program from non-Federal funds the \$2,316,652 for principal and interest paid on the unused \$5 million loan.
- 1C Instruct the grantee to discontinue charging the CDBG Program for principal and interest while the loan proceeds remain idle.
- 1D Require the grantee to reimburse the LGA Program \$148,682 for the Borinquen property it does not own. Proceeds received for the land used for the construction of the State Police Headquarters (\$815,560) and State Insurance Fund (\$353,735) should be recorded as program income as discussed in Finding 2.
- 1E Determine the eligibility of LGA activates totaling \$1,878,290 (\$30,250 for Sabalos Ward, \$128,212 for Borinquen Avenue, \$384,255 for 22.8 "cuerdas", \$155,178 for NAPA property, \$27,481 for private citizen sale, \$453,502 for land in option status, and \$699,412 for Villa Sultanita property). Any cost found to be ineligible must be reimbursed to the Section 108 LGA from non federal funds. In determining eligibility HUD should consider the evidence showing that the activities met at least one of the national objectives and that funds were used for authorized purposes. Also HUD should consider the fair market value or sales proceeds in determining the amounts to be reimbursed to the program.

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Grantee's Controls Over Program Income Were Inadequate

The grantee did not account for or report all program income obtained from activities assisted with CDBG or LGA funds. We believe that this occurred because: (1) the grantee's financial management system did not comply with HUD requirements for ensuring that accounting records are current, accurate, and complete; (2) the grantee did not properly monitor income producing activities administered by a subgrantee; and (3) the grantee disregarded HUD requirements. As a result, the grantee did not have adequate assurance that all program income was used for eligible activities and before additional drawdowns were made from the letter of credit.

24 CFR 570.504(a) provides that the receipt and expenditures of program income shall be recorded as part of the financial transactions of the grant program. Additionally, 24 CFR 570.504(b)(2)(ii) indicates that program income shall be disbursed for eligible activities before additional cash withdrawals are made from the U.S. Treasury.

PROGRAM INCOME GENERATED BY SUBGRANTEE

The subgrantee, CPDO, sold 11 lots of land between July 1985 and July 1995 in the amount of \$2,186,318 as follows:

<u>Date</u>	<u>Price</u>	<u>Purpose</u>
07/05/85	\$ 67,500	Construction of bowling alley
09/22/88	201,000	Construction of medical facilities
03/27/89	353,735	State Insurance Fund Agency
12/21/89	154,070	Construction of turnkey project
03/21/91	320,000	Construction of medical facilities
12/14/91	1,794	Annex to existing private property
10/20/92	90,000	Parking for bowling alley
03/04/93	155,178	Construction of automobile parts store
01/27/95	12,018	Annex to existing private property
05/10/95	15,463	Annex to existing private property
07/18/95	<u>815,560</u>	Construction of State Police Command Center
Total	<u>\$ 2,186,318</u>	

These properties were originally acquired by the grantee using Section 108 LGA funds, and subsequently transferred to CPDO for development. Accordingly, all the proceeds generated from the sale of the above properties are considered program income. The grantee did not have any procedures to report or account for the program income generated by its subgrantee, CPDO.

IMPROPER USE OF UDAG LOAN REPAYMENTS

The grantee established a revolving fund from the program income generated from the repayment of UDAG loans. As of March 1996, the revolving fund had a bank balance of \$157,519 plus a \$120,000 certificate of deposit. In addition, the books reflected an account receivable from the HOME Program of \$177,298. Accordingly, the revolving fund had a balance of \$454,817.

Paragraphs 2.04(c) & (d) of the UDAG grant agreement states that all program income received shall be used by the recipient for community or economic development activities eligible for assistance under Title I of the Act. Furthermore, OMB Circular A-87, paragraph C.2.c provides that any cost allocable to a particular grant or cost objective may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreement, or for other reasons.

Our review disclosed the grantee used the revolving fund as a "petty cash account" to finance shortages from other Federal programs. These disbursements were recorded in the books as accounts receivable. Some of the advances to other programs were as follow:

<u>Check Number</u>	<u>Date</u>	<u>Amount</u>	<u>Comments</u>
36	12/20/91	\$ 66,000	Advance to UMTA Program, reimbursed on 2/12/92.
67	01/21/93	229,727	Advance to CDBG Program, reimbursed on 1/26/93.
82	08/02/93	90,880	Advance to EDA Program, reimbursed on 11/29/93.
100	04/09/94	177,298	Advance to HOME Program, not reimbursed.
N/A	03/10/95	10,232	Advance to CDBG Program, reimbursed on 11/27/95.

The HOME Program still owed the revolving fund \$177,298 for the advance made on April 9, 1994. The funds were used for the purchase and installation of 11 modular homes that were to be developed under the HOME Program.

PARKING FACILITIES INCOME NOT RECORDED

The grantee leased the Luis Muñoz Rivera and the Market Place parking facilities to a private contractor. The lease was for a 5 year term, starting November 16, 1994 with a monthly fee of \$4,960 for both facilities. The Assistant Administrative and Fiscal Affairs officer advised that

these facilities were built with CDBG funds. The income generated from the lease is program income, but the grantee did not record it as such. We estimated that for the last 24 months the lease of these facilities may have generated program income in the amount of \$119,040.

Deficiencies regarding the grantee's inadequate controls over its program income were disclosed in HUD's monitoring report dated June 6, 1994. Although over 2 years have elapsed, the grantee had not taken any corrective actions to resolve the problem.

AUDITEE COMMENTS

The auditee agreed with the finding.

RECOMMENDATIONS

We recommend that you instruct the grantee to:

- 2A Transfer the \$2,186,318 of program income generated by the subgrantee in the sale of land (including any interest received on payment plans) to the CDBG account. These funds should be used for eligible CDBG activities prior to making additional drawdowns from the letter of credit.
- 2B Transfer the \$454,817 or present balance of the revolving fund to the CDBG account to be used for eligible CDBG activities prior to making additional drawdowns from the letter of credit.
- 2C Transfer \$119,040 of program income related to the lease of the parking facilities from its general funds to the CDBG account. This income should be used prior to making additional drawdowns from the letter of credit.
- 2D Establish all necessary controls for identifying, recording, and using program income and miscellaneous revenue in accordance with program regulations, including its subgrantee.

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Municipal Employees' Salaries Were Improperly Allocated To Public Service Activities

The grantee improperly allocated to various CDBG funded public services activities the salaries of municipal employees carrying out the regular responsibilities of the unit of general local government. In doing so, the grantee disregarded CDBG Program requirements. As a result, the grantee charged the CDBG Program \$1,493,907 of ineligible costs during fiscal years 1993 through 1996. Additionally, \$562,443 budgeted for Fiscal Year (FY) 96-97 is considered a cost efficiency.

CRITERIA

24 CFR 570.201(e) Public Services states that to be eligible for CDBG assistance, a public service must be either a new service, or a quantifiable increase in the level of an existing service above that which has been by or on behalf of the unit of general local government. 24 CFR 570.207(a)(2) provides that except as otherwise specifically authorized in this subpart or under OMB Circular A-87, expenses required to carry out the regular responsibilities of the unit of general local government are not eligible for assistance under this part.

NO NEW SERVICE OR QUANTIFIABLE INCREASE PROVIDED

The following schedule shows the amount of reported public service expenditures and the amount budgeted for the latest fiscal years:

Program Activity	Reported Expenditures For:			Budget For
	FY 93-94	FY 94-95	FY 95-96	FY 96-97
Municipal Police			\$112,635	\$83,000
Doctors & Nurses	\$212,350	\$359,809	\$204,242	\$204,943
Health & Community Services	\$204,205	\$170,969	\$229,697	\$274,500
TOTALS	\$416,555	\$530,778	\$546,574	\$562,443

A grantee official provided the name, Social Security number, position, salary and place of work for the employees charged to the various public service activities. The expenditures charged to the CDBG Program included their salaries and fringe benefits. The following examples illustrate the nature of the activities:

a. Municipal Police:

According to a grantee official, the costs charged to the activity for FY 1995-96 consisted of payment of a special bonus for being in a "high risk" position. The municipal police salary was charged to local (municipal) funds and the extra pay was charged to CDBG funds as follows: 47 Guards and 22 cadets at \$100 each, 10 guards at \$150 each, and \$200 for the Police Commissioner.

b. Doctors and Nurses:

This activity was charged for the total salary and fringe benefits of 15 employees in the following positions: practical nurses (4), nurse's assistant (1), laboratory assistant (2), pharmacist's assistant (3), X ray technician (1), general doctor, internist, neumologist and cardiologist. Additionally, the activity was charged \$300 monthly representing a salary allocation of the Hospital Quality Control Coordinator and \$225 monthly for the pharmacist in charge for hospital pharmacy. These employees were not concentrated in an area; they were working in different areas of the general hospital.

c. Health and Community Services:

This activity includes 24 employees; 10 working at the hospital and 14 at Municipal Asylum. The positions were for laborers (9), clerks (7), accounting assistants (2), communal workers (2), receptionist (1), barber (1) kitchen assistant (1) and a guardian (1).

We concluded the employee positions were of a nature for carrying out the regular responsibilities of the general government. These employees were working in different areas of the hospital, the Municipal Guard, and the Municipal Asylum. The San Antonio Municipal Hospital had been in operation over 100 years and the Municipal Asylum over 50 years. The grantee did not provide new services or a quantifiable increase in the level of the existing services above that which had been provided before using CDBG funds.

Since the grantee had not provided either a new service or a quantifiable increase in the level of service, we consider the reported expenditures (\$1,493,907) as ineligible. Additionally, we consider the amount budgeted for FY96-97 a cost efficiency.

AUDITEE COMMENTS

The auditee claimed that the hospital has increased its services in areas such as pharmacy, laboratory, and X rays and had created new services such as pediatrics and social work.

With respect to the Municipal Guard, the auditee claimed that the bonus paid from CDBG was to compensate for new responsibilities assigned to the guards; a quantifiable increase in the level of services.

Lastly, the auditee claims that the services rendered at the municipal asylum and in the community centers are new services.

EVALUATION OF AUDITEE COMMENTS

The auditee did not submit documentation to support their claims.

RECOMMENDATIONS

We recommend that you:

- 3A Require the grantee to reimburse the ineligible costs of \$1,493,907 to the CDBG Program from non federal funds.
- 3B Instruct the grantee to reprogram the \$562,443 budgeted for FY 1996-97 for these activities.

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Unnecessary Engineering Services Were Charged to CDBG And Section 108 LGA Programs

The grantee charged the CDBG and Section 108 LGA Programs for duplicate and unnecessary engineering services. We attribute these deficiencies to the grantee's poor planning and disregard of program requirements. As a result, the grantee charged the Programs \$441,800 of ineligible costs.

CRITERIA

OMB Circular A-87 (Attachment A: Paragraph A.2.a), states the grantee is responsible for the efficient and effective administration of grant programs through application of sound management practices. Paragraph C.1.a states that to be allowable under a grant program, costs must be necessary and reasonable for proper and efficient administration of the grant. Paragraph C.2.a states a cost is allocable to a particular cost objective to the extent of benefits received by such objective.

24 CFR 85.40 states that grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

UNNECESSARY CHARGES DUE TO POOR PLANNING

Construction Drawings for Villa Sultanita's Baseball Park

On September 13, 1982 the grantee executed an \$83,000 contract for the design, drawings, and specifications for the construction of a baseball park at Villa Sultanita Development. In February 1984 it amended the contract by \$7,800 for the preparation of an environmental assessment. From December 1983 to June 1985, the grantee paid \$86,500 for such services from Section 108 LGA funds.

In June 1985 the grantee decided to relocate the baseball park and construct "Plaza Taína" (a fast food center) at the original site proposed for the baseball park. Plaza Taína was never constructed. On January 15 and July 14, 1986 the grantee contracted for \$35,700 and \$8,900 with another engineer for design and construction drawings for the relocated baseball park. The grantee paid \$45,020 for these services from Section 108 LGA funds.

The grantee did not use the drawings, specifications, or the environmental assessment prepared by the first engineer for the baseball park. The \$86,500 paid to the original engineer is evidence of the grantee's poor planning, and waste of program funds. Therefore, the charge of \$86,500 is considered unnecessary, contrary to OMB Circular A-87, and an ineligible program cost.

Duplicate payments for drawings of Villa Sultanita Development

The grantee charged the Section 108 Loan Guarantee Program \$22,000 for engineering services, which were unnecessary and duplicative. Our review disclosed the services billed by the engineer on January 7, 1982 were included in the scope of services of a contract executed with another engineer on November 29, 1979.

The payment of \$22,000 was made in December 1982 upon presentation of an invoice dated January 7, 1982. The invoice was for the preparation of schematic (blueprints, sketch) plan and for obtaining the approval for project location. These same services were paid to the previous engineer in 1980 according to the documents supporting the payments. Therefore, the \$22,000 paid to the second engineer for the schematic blueprints and the location approval is a duplicate cost and therefore is ineligible.

Other Unnecessary Expenditures for Engineering Services

The grantee gave \$400,000 of CDBG Program funds to CPDO to study, design and develop drawings for housing and commercial units at Villa Sultanita project. CPDO executed two contracts for engineering services on May 18, 1983 for \$188,500, and August 22, 1983 for \$205,000. The contracts provided for the preparation of preliminary and final drawings, cost estimates, specifications, and approval of governmental units as part of the commercial and residential development of Villa Sultanita. From June to August 1983, CPDO made payments of \$189,000 on the first contract. CPDO made payments of \$144,300 from August 1983 to January 1984 for the second contract.

The drawings were not used. Instead, a State Police Headquarters Building was built on the site previously designated for housing. Accordingly, the grantee charged unnecessary and ineligible costs to the program of \$333,300.

PROCUREMENT DEFICIENCIES

The grantee did not provide evidence of compliance with HUD procurement requirements contained in 24 CFR 85.36 (d) and (f) for the awarding of the engineering contracts. 24 CFR 85.36 (d) requires grantees to request proposals from an adequate number of qualified sources

and to award the contract to the responsible firm whose proposal is most advantageous to the Program, with price and other factors considered. 24 CFR 85.36 (f) states that grantees must perform a cost or price analysis in connection with every procurement action.

Additionally, the contracts did not include the following contract provisions required by 24 CFR 85.36i(1), (2), (10), and (11):

1. Administrative, contractual, or legal remedies when the contractor violates or breach contract terms.
2. Termination for cause and for convenience by the grantee.
3. Access by the grantee, subgrantee, the Federal Grantor Agency, the Comptroller General or any of their authorized representatives to any books, documents, papers and records of the contractor.
4. Retention of records.

AUDITEE COMMENTS

The grantee stated that they did not have information explaining why the original baseball drawings were not used. They indicated that this should be explained by CPDO.

The grantee agreed the engineer received \$22,000 which was unnecessary and a duplicate charge. They have initiated legal action requesting reimbursement for unnecessary or excess payments.

The grantee's present administration has no information why the CPDO and the previous administration conducted their procedures as they did.

RECOMMENDATIONS

We recommend that you:

- 4A Require the grantee to reimburse ineligible costs of \$108,500 to the Section 108 LGA B-79 Program and \$333,300 to the CDBG Program.
- 4B Require the grantee to submit a corrective action plan showing how it will assure compliance with 24 CFR 85.36, regarding the procurement deficiencies discussed in this finding.

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Road Improvement Projects Were of Questionable Benefit

The grantee used CDBG Program funds for road improvements, but did not maintain documentation to demonstrate compliance with the CDBG national objectives. The project files did not show the boundaries of the service area, the income characteristics of the families in the service area, or even a full description of the activity. The grantee's GPR reported all projects as benefiting low and moderate income families based broadly on the results of the 1990 census without identifying specific beneficiaries of each. Furthermore, it incurred ineligible maintenance and repair costs. As a result, program costs in the amount of \$178,059 are ineligible, while costs of \$36,054 are considered unsupported.

CRITERIA

24 CFR 570.200 states that a grantee must ensure and maintain evidence that each of its CDBG funded activities meets one of the program's three national objectives: benefit to low and moderate income families, aid in the prevention or elimination of slums or blight, or for activities having a particular urgency. 24 CFR 570.506 prescribes the type of documentation needed to demonstrate compliance.

ROAD IMPROVEMENTS FOR OTHER THAN LOW/MODERATE INCOME AREAS

The grantee used CDBG funds to repave various roads within the Municipality. Among these were road improvements in:

<u>Area</u>	<u>Cost Incurred</u>
Vista Verde	\$ 38,808
Los Ingenieros Road	29,621
Malecon Pier Area	16,000
Alturas de Mayaguez	8,944
Total	\$ 93,373

Although the grantee reported the road improvements in these areas as benefiting low and moderate income persons, it did not maintain records to support the claim. The Executive Director of the Federal Programs and Housing Department agreed that these were not low/moderate income areas. Accordingly, the costs of \$93,373 are ineligible.

INELIGIBLE MAINTENANCE AND REPAIRS

The grantee charged \$30,255 to the CDBG Program to purchase 999 tons of asphalt. Details are as follows:

<u>Payee</u>	<u>Check No.</u>	<u>Date of Check</u>	<u>Tons Purchased</u>	<u>Amount</u>
Betteroads Asphalt	20575	08/23/91	100	\$ 3,250
Betteroads Asphalt	20652	09/27/91	100	3,250
Betteroads Asphalt	20711	10/14/91	100	3,250
Betteroads Asphalt	20731	10/18/91	100	3,250
Betteroads Asphalt	20864	11/18/91	100	3,250
Betteroads Asphalt	21863	08/20/92	99	3,118
Betteroads Asphalt	21962	09/18/92	100	3,150
United Asphalt	25263	08/23/94	<u>300</u>	<u>7,737</u>
TOTAL			<u>999</u>	<u>\$ 30,255</u>

The grantee's Chief of Streets and Roads said the asphalt was used for filling pot holes in the streets and roads. The filling of pot holes in streets and roads is not an eligible activity as prescribed in 570.207(b)(2)(I) of 24 CFR. Accordingly, expenditures of \$30,255 are ineligible.

IMPROVEMENTS TO PRIVATE PROPERTIES

The grantee used \$82,256 of CDBG Program funds to construct roads on private properties. Although the grantee reported these activities as benefiting low/moderate income persons, it did not have documentation to support the claim. Furthermore, it is very questionable to use CDBG funds to improve properties which the grantee did not own. Specifics are as follow:

Los Berrios Road - The grantee charged the CDBG Program \$51,056 for the construction of Los Berrios road. The grantee did not provide any documentation evidencing the scope of the work, the grantee's ownership of the property, or compliance with one of three national objectives. Furthermore, a site inspection disclosed that this road is abandoned and that all the work done at this site was damaged and lost due to heavy rains.

In summary, the costs charged by the grantee are ineligible because improvements were made to a private property, the activity did not meet a national objective, and the project was abandoned resulting in a waste of federal funds. Accordingly, expenditures in the amount of \$51,056 are ineligible.

Las Hortencias Road - The grantee charged \$31,200 to the CDBG Program for the construction of Las Hortencias road. The grantee did not provide any documentation evidencing the scope of the work, or compliance with one of the three national objectives. Furthermore, the grantee could not identify the use given to 600 concrete blocks purchased with CDBG funds for this activity. The boxed culvert was built with reinforced concrete and not concrete blocks. The owner of the property authorized the construction of the road in exchange for the construction of a fence along the new road and the installation of electricity to the area. The grantee alleged that the road was constructed to provide a second access to Las Hortencias community. However, a site inspection disclosed that the road was closed to public use. Also there was no housing or any other kind of structure near the construction site, so the activity does not benefit anyone other than the property owner.

The use of CDBG funds to construct an access road across a private property is questionable. Although the road is completed, it is kept closed and apparently benefits only the property owner. Therefore, we consider expenditures of \$31,200 as unsupported.

WORK AND MATERIALS THAT COULD NOT BE LOCATED

Carey Street (El Mani Sector) - The grantee charged the CDBG Program \$4,854 for the construction of a culvert at Carey Street located at El Mani community. Grantee files did not contain any documentation describing the scope of the work or any plans or specifications. Among the charges to this activity were the purchase of 2,192 concrete blocks, 336 cement bags, 100 pounds of nails, etc.

Based on a site inspection and an interview with the foreman, the grantee could only account for about 800 of the 2,192 concrete blocks purchased and charged to the CDBG Program for this activity. This illustrates the grantee's inadequate controls to safeguard program assets. Accordingly, expenditures in the amount of \$4,854 are considered unsupported.

Sidewalks and Curbs (City Wide) - The grantee disbursed \$3,375 in CDBG funds for the purchase of 50 cubic yards of concrete. The grantee claimed it used the concrete to repair sidewalks within the municipality, but could not show where it was used. Furthermore, grantee files did not contain any documentation describing the scope of the work, plans or specifications, or the site(s) where this activity would take place. The purchase order described this activity as "to repair sidewalks and curbs in the streets of the Municipality of Mayaguez." The description indicates the activity was for normal operating and maintenance expenses, which are not eligible under 24 CFR 570.207(b)(2)(i). Accordingly, expenditures of \$3,375 are ineligible.

AUDITEE COMMENTS

Grantee officials stated they would perform an evaluation of all census data used to determine the eligibility of the activities.

Grantee officials agreed with the finding dealing with Los Berrios Road. They said the Las Hortencias road was constructed in response to a petition from the residents. They also indicate an agreement has been reached with the owner to transfer ownership of the property without cost. They claim the concrete blocks were used for construction of a retaining wall at a basketball court.

Grantee officials claim that a total of 2,016 concrete blocks were used for the construction of the culvert at Carey Street. They said they obtained this information from a handwritten report dated January 14, 1997 by the engineer who previously worked on the project.

Grantee officials advised that they were still reviewing the issues concerning the sidewalk repairs.

EVALUATION OF AUDITEE COMMENTS

The grantee did not address the fact that they had not documented compliance with national objectives as prescribed by 24 CFR 570.506. The grantee failed to indicate corrective actions to address the lack of supporting documentation for grant funded activities. Furthermore, the grantee should be reminded that the census reports should be used as a guide to determine eligibility and not as an absolute instrument to determine compliance. The grantee did not address the issue that CDBG funds were used for ineligible maintenance and repairs (filling pot holes and repairing sidewalks).

The grantee did not provide any documentation concerning the concrete blocks used for the basketball court. As a minimum, the fact that materials charged to one project were used at another site reflects the grantee has inadequate controls to account for program funds.

The grantee's comments concerning the number of concrete blocks used at Carey Street are contrary to our site inspection and information provided to us by the foreman who worked at the site.

RECOMMENDATIONS

We recommend that your office:

- 5A Instruct the grantee to reimburse the ineligible costs of \$178,059 to the CDBG Program from non-Federal funds.

- 5B Determine the eligibility of the unsupported costs totaling \$36,054 and advise the grantee accordingly. All ineligible amounts should be reimbursed by the grantee to the CDBG program.
- 5C Require the grantee to submit an action plan to ascertain that responsible CDBG officials become familiar with CDBG regulations pertaining to evidence demonstrating that funded activities meet at least one of the three national objectives.

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Ineligible Administrative Expenses Were Charged To The CDBG Program

The grantee misused \$97,334 of CDBG Program funds on administrative expenditures. The expenses involved unrelated, unnecessary, or wasteful activities. We attribute these deficiencies to the grantee's disregard of applicable requirements. These costs should be borne by the grantee.

OMB Circular A-87, paragraph C.1a states that to be allowable under a grant program, costs must be necessary and reasonable for proper and efficient administration of the grant program, be allocable thereto under these principles, and except as specifically provided, not be a general expense required to carry out the overall responsibilities of State or local government. A cost is allocable to a particular cost objective to the extent of benefits received by such objective (Paragraph C.2a). Any cost allocable to a particular grant or cost objective under the principles provided in the Circular may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons (Paragraph C.2b).

EMPLOYEE DID NO WORK FOR THE PROGRAM

The grantee charged the CDBG Program \$48,142 for salaries and fringe benefits of an employee who did no work during a two year period. A grantee official confirmed the charge to the CDBG Program and that no work was performed, but claimed that the failure to work was due to the employee's insubordination. The employee claimed that the grantee removed all his responsibilities. The charges of \$48,142 served no benefit to the CDBG Program and are not allowable. The \$360 for a 1996 Christmas Bonus the employee was to receive, would also be ineligible.

CONSULTING SERVICES WERE GENERAL GOVERNMENT EXPENSES

The grantee charged the CDBG Program \$10,170 for financial consulting services that were a routine responsibility of the municipality. The contract included: (a) providing financial and administrative orientation to the Municipal Assembly and key municipal officers; (b) advising the Mayor for the effective management of the municipal budget; (c) collaborating with the Mayor in preparation of a municipal ordinance to be presented at the Municipal Assembly; and (d) collaborating in the development of the annual municipal budget. These services are general government expenses and therefore ineligible under CDBG.

COMPUTER SERVICES CONTRACT NOT IMPLEMENTED

In April 1993, the grantee executed a \$40,000 professional services contract to automate the Section 8 program and areas that complemented the program. The contractor was also to provide assistance with the bidding process and evaluation of the bids. The costs were to be charged to the Section 8 Program. In December 1993, the grantee awarded a contract for the installation of the computer system. In February 1995, the grantee executed another professional services contract to coordinate and supervise the installation of the computer system in the areas of Section 8, Finance and Accounting, and provide training.

A grantee official advised that plans for the computer system were canceled around May 1995. However, in July and August 1995, the grantee charged the CDBG program \$30,290 and \$1,072 for the professional services contracts. The costs of \$31,362 are ineligible, because no benefit was provided to the CDBG program.

IMPROPER CHARGES BY CONSOLIDATED PLAN CONTRACTOR

On January 13, 1995, the grantee contracted with a consultant to complete and submit to HUD the 1995 Consolidated Plan for the Municipality of Mayaguez. On January 24, 1995, the consultant submitted an invoice which included "initial operating costs" (fringe benefits, computer equipment, transportation and maintenance costs) in the amount of \$4,300. The grantee requested and received additional explanations for the charges. On February 23 the grantee denied the costs because they were excessive and contrary to municipal ordinance and regulations. The consultant submitted a second invoice the following day in which the "initial operating costs" were deleted and disguised as additional hours worked. The grantee paid the second invoice.

Although consulting services are allowable, charges for "initial operating costs" of a consultant's business are not necessary for the administration of the CDBG Program. Furthermore, 570.207(b)(1) provides that the purchase of equipment is ineligible. Accordingly, "initial operating costs" of \$4,300 are ineligible.

In addition, the consultant's invoices included time to attend various training seminars. The grantee paid the invoices and charged the costs to the CDBG Program for the following training:

<u>Purpose</u>	<u>Amount</u>
Attend HUD Seminar on Consolidated Plan (5 Day Seminar)	\$ 2,400
Attend Computer Training (MAP INFO)	480
Attend Tourism Symposium	<u>480</u>
TOTAL	<u>\$ 3,360</u>

Expenditures of \$3,360 are also ineligible because the consultant should have attended the seminars on his own time and at his own expense.

AUDITEE COMMENTS

The grantee claimed that the employee was insubordinate and it should not be penalized for his poor performance. The grantee stated that the financial consultant's work included identifying other sources of Federal funds, and services related to the CDBG and Section 108 Programs. The grantee proposed to prorate the expenses, and account for any difference as indirect costs.

The grantee is evaluating the issues concerning the contract for the Section 8 Program.

The grantee claims that the consolidated plan consultant's invoice which included the equipment and other ineligible charges was never paid. Furthermore, they contend that the attendance of the consultant at the seminars was necessary to accomplish the work for which he was recruited.

EVALUATION OF AUDITEE COMMENTS

We have no objection to the auditee's proposal of prorating charges. In our opinion, the invoices do not contain sufficient information to prorate the charges for the financial consultant. Most of the services rendered were of a general government nature like drafting municipal ordinances, meetings with state officials for obtaining loans, meetings to increase local taxes, etc. Also, the grantee did not provide evidence of an approved Indirect Cost Proposal.

The finding addressed the fact that the consultant submitted a second invoice to conceal the ineligible charges after being questioned by grantee officials. The invoice containing the ineligible items, dated January 24, 1995, was substituted with an invoice dated February 24, 1995. The second invoice represented 167 hours of work for an 8 day period between January 16 and January 24, for an average 21 hour work day. We contend the consultant submitted a second invoice to disguise the ineligible costs.

In relation to the seminars, the consultant was allegedly hired for his expertise to do the work. It is not reasonable and necessary for him to charge for attending seminars to learn how to complete the Consolidated Plan. This should be done on his own time and at his expense.

RECOMMENDATIONS

We recommend that your office:

- 6A Sustain the ineligible costs of \$97,334 (\$48,142 for the employee, \$10,170 for financial services contract, \$31,362 for the computer services contract, and \$4,300 + \$3,360 for the consolidated plan contractor) and instruct the grantee to reimburse that amount to the CDBG Program from non-Federal funds.
- 6B Instruct the grantee not to pay the \$360 Christmas bonus. If it has been paid, then this cost should also be disallowed.

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The Grantee Charged Ineligible Costs to Interim Assistance Activity

The grantee continued to charge the CDBG Program for the lease of equipment used at the municipal landfill after the state of emergency for which the funds were approved had ended. This was done in disregard of HUD's specific directives contained in the letter approving the use of CDBG funds for this activity. Accordingly, expenditures in the amount of \$44,500 are ineligible.

24 CFR 570.201(f)(3), provides that CDBG funds may be used as interim assistance in emergencies, but are limited to the extent necessary to alleviate the emergency conditions.

On June 10, 1995, the grantee requested HUD approval to use \$102,000 of CDBG Program funds to lease equipment for the municipal landfill to alleviate the emergency created by hurricanes Luis and Marilyn, a situation threatening the public health. HUD authorized the lease of equipment and machinery on October 13, 1995 on the condition that the activity undertaken did not go beyond what was necessary to alleviate the emergency condition, pursuant to 24 CFR 570.201(f)(3).

The Director of the Environmental Control Department advised the Mayor on January 2, 1996, to end the state of emergency at the municipal landfill. Nevertheless, the grantee continued to charge the lease of equipment to the CDBG Program through May 11, 1996 totalling \$44,500 in excess of its authorization. The \$44,500 is ineligible.

AUDITEE COMMENTS

The grantee claims that the Mayor ended the state of emergency on May 1996 and that contracted services continued until their completion.

EVALUATION OF AUDITEE COMMENTS

Our conclusion remains unchanged. The Director of the Environmental Control Department, who is an engineer, advised on January 2, 1996 that the state of emergency at the municipal landfill was over, since the needed work was completed. The grantee did not provide any documentation that could justify work beyond January 1996 as an emergency condition.

RECOMMENDATION:

We recommend that you:

- 7A Sustain the \$44,500 of ineligible costs and require the grantee to reimburse this amount to the CDBG Program from other than Federal funds.

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Grantee Did Not Properly Administer CDBG Housing Rehabilitation Program

The grantee did not administer its housing rehabilitation program in an effective and efficient manner. The grantee had not established procedures for selecting applicants from a waiting list, did not prepare inspection reports or work write ups for the work to be prepared, and did not maintain proper control of construction materials. We found ineligible costs of \$3,000, a cost efficiency of \$6,472, and unsupported costs of \$17,706.

Paragraph 2.a of Attachment A of OMB Circular A-87 provides that grant recipients are responsible for the efficient and effective administration of grant and contract programs through the application of sound management practices.

A HUD monitoring report dated June 6, 1994 disclosed problems with the grantee's waiting list, selection of applicants, and inspection procedures. Our review showed the grantee had not implemented adequate corrective action.

INELIGIBLE APPLICANTS SELECTED FROM WAITING LIST

The grantee maintained a waiting list of participants who desire to participate in the rehabilitation program. At September 1996, the list included 1,600 applicants. However, they were not necessarily qualified applicants because the grantee had not made an eligibility determination before placing them on the list. Furthermore, the grantee had not established the criteria to be used in selecting applicants from the list.

Grantee records did not show justification for selecting applicants to be assisted under the program. For example, we reviewed a list of 19 properties to be rehabilitated in May 1996. We noted that 8 were not listed on the waiting list, and there was no documentation concerning how the other 11 were selected.

We also noted that two of the participants had earnings over the income limits established by the grantee. One of these cases pertained to a municipal employee. At the audit date the rehabilitation work was in progress and the grantee had charged ineligible costs of \$3,000 for labor costs and had obligated CDBG funds of \$6,472 (cost efficiency) for material costs. The rehabilitation work for the other case had not started at our audit date.

LACK OF PROPER INITIAL INSPECTION REPORTS

There were no initial inspection reports of violations. Instead the grantee filled out a form on the physical condition of the house. The form was filled out using check marks to indicate whether the condition of some areas of the house was excellent, regular, deteriorated or did not exist. There were

no work write ups addressing code violations, or repair specifications for the rehabilitation work that needed to be done at the property.

SUPPLIER PAID FOR CONSTRUCTION MATERIAL NOT DELIVERED

Our review of purchase orders and books of accounts disclosed the grantee improperly made disbursements to a lumber company amounting to \$17,706 for materials ordered but not delivered. During our site inspection of 17 selected cases we found that on 7 cases the grantee made disbursements for construction materials not delivered to the program participants. A grantee official stated that they kept the yellow copy of the invoice to be used to receive the material from the supplier when the rehabilitation starts.

We believe that this procedure is a departure from sound practices, and the lack of controls increases the risk of mismanagement. The grantee's internal control procedures to safeguard program assets were not adequate to ensure that payment is made only for services and/or supplies received. Therefore, the grantee's management practice of the program was inadequate.

AUDITEE COMMENTS

The grantee stated that they are in the process of "debugging" the waiting list. During this process letters will be sent to applicants to determine if they are still interested in the program. Program eligibility will be determined for those who respond that are still interested. The grantee advised that the case of the employee will be re-evaluated and pertinent corrective action will be taken. The grantee said they will process the other case through the HOME Program since income requirements are less.

The grantee advised that they are in the process of adopting the Section 8 Program inspection reports for the rehabilitation program.

The grantee stated that the materials for all seven cases have now been delivered. In four cases the rehabilitation work has started. Furthermore, they will establish controls to assure proper management of the activity and the financial system.

RECOMMENDATIONS:

We recommend that you require the grantee to:

- 8A Update the waiting list to include only qualified applicants.
- 8B Establish the criteria it will use for the selection of applicants from the list.
- 8C Establish written procedures to assure proper initial inspection reports and that payments are made only for materials or services delivered.

8D Reimburse the CDBG Program \$3000 spent for the rehabilitation of the employee's house and reverse the obligation for the remaining \$6,472.

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Grantee's Financial Management System And Procurement Practices Needed Improvement

The grantee's financial management system and procurement practices for CDBG and LGA activities needed improvement. The grantee's accounting records were deficient, its financial reports were not timely or accurate, and there was no assurance that goods and services were acquired at the most advantageous terms. The deficient financial management system and procurement procedures were due to the low priority assigned to the program's financial system and the grantee's disregard of applicable HUD requirements. These deficiencies have contributed to other audit findings in this report. The amount of \$1,000 was ineligible and \$310,533 was unsupported.

INADEQUATE FINANCIAL MANAGEMENT SYSTEM

We noted the following deficiencies pertaining to the grantee's accounting records and financial reports related to the CDBG and LGA activities.

- Disbursements were not supported. For example, the grantee charged the CDBG Program \$163,485 for rehabilitation wages for the San Antonio Municipal Hospital. However, the grantee did not provide any source documentation (payrolls, titles, job descriptions, scope of work,) to support such charges. 24 CFR 85.20(b)(6) requires that accounting records be supported by such source documentation as canceled checks, paid bills, payrolls, time and attendance records. The only document provided was the environmental report which described the labor work as "minor rehabilitation as installation of windows and doors, painting, etc." This work could be considered general maintenance of a public facility and therefore ineligible. We consider expenditures of \$163,485 as unsupported pending a HUD eligibility determination.
- Salary expenses were improperly allocated to a project activity. The salary of the Human Resources Supervisor, (an administrative position) was charged to the Housing Rehabilitation activity as an activity delivery cost. This position is one which is considered general management, oversight, and coordination of the program, and thus should be charged as CDBG program administration costs. Accordingly, expenditures of \$29,840 through September 30, 1996, were misclassified and should be corrected. The grantee should make proper allocation for the remaining \$5,890 payable to the employee from October 1, 1996, through June 30, 1997.

- CDBG funds were used to finance shortages of another Federal Program. On October 18, 1991, the grantee advanced \$31,000 in CDBG Program funds to a Federal Transportation Agency (FTA) Program to cover a fund deficiency. The grantee reimbursed \$30,000 to the program on January 11, 1995, leaving a balance of \$1,000. None of these transactions were recorded in the general ledger of the CDBG Program. The unpaid balance of \$1,000 is not an allowable program cost and should be repaid.
- GPR financial data submitted to HUD contained amounts that were not accurate or reliable. Salaries reported in the 1995 GPR were an estimate and could not be traced to the accounting records. Furthermore, salary expenses have not been posted to the CDBG accounting records since March 19, 1995.

Similar deficiencies in the grantee's financial management system were disclosed by HUD in its monitoring report dated June 6, 1994. However, the financial management system still did not comply with program requirements.

POOR PROCUREMENT PRACTICES

The grantee did not comply with procurement requirements as prescribed by 24 CFR 85.36. The grantee did not perform a price or cost analysis, and did not follow required competitive proposal procedures in obtaining professional and construction services. As a result, the procurement process was not conducted in a manner providing full and open competition, and the grantee cannot assure that goods and services were obtained at the most advantageous terms. The following examples illustrate the deficiencies:

- San Antonio Municipal Hospital Rehabilitation - The grantee contracted certain services with independent contractors for the rehabilitation of the San Antonio Municipal Hospital as follow:

<u>Purpose</u>	<u>Amount</u>
Hospital Gas System Equipment	\$ 74,507
Acoustic Ceiling	40,400
Electrical System	54,254 ²

The grantee did not have evidence to demonstrate that the procurement process for the electrical system and the hospital gas equipment, were conducted in a manner providing full and open competition. Furthermore, the grantee did not award the acoustic ceiling contract to the lowest proposal. The grantee selected the second highest quotation, representing an excessive expenditure of \$12,900, without providing any justification.

² This contract had two sources of funding, \$19,865 CDBG and \$34,389 from local funds.

The grantee did not provide documentation that could demonstrate that an independent cost or price analysis was conducted to determine the reasonableness of the proposed contract prices. 24 CFR 85.36(f) requires the grantee to perform a cost or price analysis in connection with every procurement action, including contract modifications.

The grantee approved change orders that increased the contract costs without any supporting documentation or justification. These were as follow:

<u>Purpose</u>	<u>Original Contract Amount</u>	<u>Amended Contract Amount</u>	<u>Amount Increase</u>	<u>Percentage Increase</u>
Hospital Gas Equipment	\$ 40,681	\$ 74,507	\$ 33,826	83%
Acoustic Ceiling	24,200	40,400	16,200	67%
Electrical System	<u>19,865</u>	<u>54,254</u>	<u>34,389</u>	173%
Total	<u>\$ 84,746</u>	<u>\$169,161</u>	<u>\$ 84,415</u>	

The Municipality paid \$34,389 of the electrical system contract with local funds. We consider the total \$134,772 (\$169,161 - \$34,389) charged to the CDBG Program as unsupported.

- Housing Rehabilitation Program

Inadequate Contract Award - The grantee's procedures for soliciting and awarding contracts for the housing rehabilitation program were inadequate. During January 1996 the grantee conducted a procurement process for rehabilitation of nineteen (19) houses under the CDBG Program. The grantee prepared letters inviting several firms to submit quotations for the rehabilitation of the houses. The grantee awarded the rehabilitation work for 18 of the 19 houses to one contractor for the amount of \$246,400. The procedures used by the grantee are contrary to 24 CFR 85.36(d)(2). The sealed bid method (formal advertising) is the required method for procuring construction services, when the costs will exceed \$100,000.

Contractor did not perform required rehabilitation work - On May 10, 1996 the grantee executed five of the 18 rehabilitation contracts totalling \$68,200. The grantee disbursed \$12,276 to the contractor for the rehabilitation of five houses. The contractor demolished all five housing units, but did not perform the rehabilitation work. On July 29, 1996, the contractor requested the grantee to cancel the contract and in a letter dated August 20, 1996 agreed to reimburse \$4,500. The grantee accepted the contractor's desire to cancel the contracts, but required the refund of all the amount paid. At the audit date the grantee was in the process of rehabilitating four of the houses using force account labor due to the contractor's default. We consider the payment of \$12,276 as unsupported because the grantee had not determined the amount of actual work performed.

The grantee did not verify whether the contractor was financially responsible or check his prior performance. The grantee should have considered the whole amount of the contracts (\$246,400) and executed one contract. Also, it should have required a bid bond and a payment and performance bond to protect the grantee's interest as required by 24 CFR, part 85.36(h).

The weaknesses have limited the grantee's ability to establish a reliable system to evaluate program performance and effectiveness. These deficiencies have affected the administration of the HUD programs and constitute serious noncompliance with program requirements. The grantee's inability to meet program requirements was due to the low priority assigned to the program's financial system and the grantee's disregard of applicable HUD requirements.

AUDITEE COMMENTS

Grantee officials stated:

Financial Management System

They are in the process of evaluating the unsupported disbursements, allocating the human resources salary as administrative expenses, and reimbursing the CDBG Program for the \$1,000 advance.

They believed the financial information provided was trustworthy since all supporting documents related to these expenses were provided.

Procurement Practices

The job descriptions identify work done at the San Antonio Hospital.

They conducted a process based on a previous formal advertising requesting interested contractors to participate in the rehabilitation of housing city wide. A formal advertising process was not conducted because they considered each unit to be rehabilitated as an individual activity that would not exceed the \$100,000 range. Nevertheless, the entire process was canceled. The issue regarding money disbursed to the contractor was referred to legal counsel.

EVALUATION OF AUDITEE COMMENTS

Financial Management System

We maintain the 1995 GPR was neither accurate nor reliable. Not all amounts reported could be traced to the accounting records maintained. Grantee officials advised that salaries reflected in the GPR were based on estimates. Furthermore, the grantee had not reported all program income as required.

Procurement Practices

The grantee did not address the issues of the finding. They did not provide evidence that could demonstrate that the procurement process was conducted in a manner providing full and open competition, nor evidence they prepared cost estimates including contract modifications.

RECOMMENDATIONS

We recommend that your office:

- 9A Require the grantee to reimburse the \$1,000 advance to the CDBG account from other than Federal funds.
- 9B Determine the eligibility of the unsupported costs totalling \$310,533 (\$163,485 for rehabilitation wages and \$134,772 for rehabilitation contracts of San Antonio Hospital, and \$12,276 for housing rehabilitation work) and advise the grantee accordingly. Any amount determined ineligible must be reimbursed to the CDBG Program from non-Federal funds.
- 9C Instruct the grantee to reclassify the \$29,840 and unpaid salary of \$5,890 as program administrative costs.
- 9D Instruct the grantee to develop and implement a financial management system that complies with requirements prescribed in 24 CFR 85.20. As a minimum, the procedures should provide for information on assets, liabilities, program income, and expenses.
- 9E Require the grantee to submit a revised 1995 GPR showing the actual expenditures instead of the estimated amounts reported.
- 9F Instruct the grantee to establish procurement policies and procedures to achieve compliance with the CDBG and other federal and local applicable regulations, including:
- Performing cost or price analyses for its procurement actions.
 - Adequately documenting the basis for awards of contracts.
 - Justification for contract amendments.
- 9G Advise the grantee that continued noncompliance with HUD requirements may result in administrative sanctions, such as changing the method of payment from a letter of credit to a reimbursement basis.

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Management Controls

In planning and performing our audit, we considered the grantee's management controls to determine our audit procedures and not to provide assurance on those controls. Management is responsible for establishing effective management controls.

Management controls include the plan of organization, methods, and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

We determined that the controls most relevant to our audit objectives pertained to the following:

1. Documenting compliance with national objectives.
2. Monitoring progress.
3. Procedures used to accumulate and charge costs to the program.
4. Accounting for program income.
5. Documenting compliance with procurement policies.

We assessed controls in place. We obtained an understanding of the auditee's procedures and HUD's requirements, assessed control risk, and performed various substantive tests of the controls.

A significant weakness exists if controls do not give reasonable assurance that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports.

Based on our review, we believe that significant weaknesses existed in all five control areas mentioned above. The specific weaknesses are discussed in the findings.

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Follow-Up On Prior Audits

This is the first OIG audit of the grantee's CDBG and LGA activities.

The grantee's single audit reports were not submitted timely. On April 19, 1995, the grantee submitted to HUD the single audit reports for fiscal years ending June 30, 1990, 1991, and 1992. The Independent Public Accountant gave a qualified opinion of the financial statements for the three years. The reports contained 23 findings pertaining to the CDBG (20) and Rental Rehabilitation (3) programs to be management controlled.

All of the findings remained open when we ended our site work in October 1996. In November 1996, the HUD Field Office received the auditee's response on them. Single audit reports for the fiscal years ending June 30, 1993, 1994, and 1995 were past due.

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Schedule Of Ineligible And Unsupported Costs, And Cost Efficiencies

<u>Recommendation No.</u>	<u>Ineligible³</u>	<u>Unsupported⁴</u>	<u>Cost Efficiency⁵</u>
1B	\$ 2,316,652		
1D	148,682		
1E		\$ 1,878,290	
2A			\$ 2,186,318
2B			454,817
2C			119,040
3A	1,493,907		
3B			562,443
4A	441,800		
5A	178,059		
5B		36,054	
6A	97,334		
6B			360
7A	44,500		
8D	3,000		6,472
9A	1,000		
9B		310,533	
9C			35,730
	<u>\$ 4,724,934</u>	<u>\$ 2,224,877</u>	<u>\$ 3,365,180</u>

³Costs not allowable by law, contract, or HUD or local agency policies or regulations.

⁴Costs which are being contested because they lack satisfactory documentation to support eligibility.

⁵An action to prevent an improper obligation, or expenditure, or to increase revenue.

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Auditee Comments

APPENDIX B, AUDITEE COMMENTS HAS BEEN DELETED FROM THIS VERSION TO FACILITATE TRANSMISSION TO THE INTERNET. PLEASE CONTACT THE OFFICE OF INSPECTOR GENERAL FOR AUDIT, DISTRICT 4 FOR THE AUDITEE COMMENTS.

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Chief Financial Officer, F (Room 10164)

Deputy Chief Financial Officer for Finances, FF (Room 10166)

Director, Housing and Community Development, Issue Area, U.S. GAO, 441 G Street, NW, Room 2474 Washington, DC 20548 ATTN: Judy England-Joseph

Counsel to the Inspector General, GC (Room 8260)

HUD OIG Webmaster-Electronic format via Electronic mail-Morris_F._Grissom@Hud.Gov

Assistant to the Deputy Secretary for Field Management, SDF (Room 7106)

The Honorable John Glenn, Ranking Member, Committee on Governmental Affairs,

n, DC 20510-6250

The Honorable Fred Thompson, Chairman, Committee on Governmental Affairs,

n, DC 20510-6250

Mr. Pete Sessions, Government Reform and Oversight Committee, Congress of the

n, DC 20515-4305

Ms. Cindy Sprunger, Subcommittee on General Oversight and Investigations, Room 212,

O'Niell House Office Building, Washington, DC 20515

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